

**THE AT&T/DIRECTV MERGER: THE IMPACT ON
COMPETITION AND CONSUMERS IN THE VIDEO
MARKET AND BEYOND**

HEARING

BEFORE THE

SUBCOMMITTEE ON ANTITRUST,
COMPETITION POLICY AND CONSUMER RIGHTS

OF THE

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UNITED STATES SENATE

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THE AT&T/DIRECTV MERGER: THE IMPACT ON COMPETITION AND CONSUMERS IN THE VIDEO MARKET AND BEYOND

TUESDAY, JUNE 24, 2014,

UNITED STATES SENATE,
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND
CONSUMER RIGHTS,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The subcommittee met, pursuant to notice, at 2:36 p.m., in Room SD-226, Dirksen Senate Office Building, Hon. Amy Klobuchar, Chairman of the Subcommittee, presiding.

Present: Senators Klobuchar, Franken, Blumenthal, Lee, and Cornyn.

OPENING STATEMENT OF HON. AMY KLOBUCHAR, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Chairman KLOBUCHAR. Good afternoon. Welcome to this afternoon's hearing. We are here today to examine a proposed merger that would combine the second largest and fifth largest video providers in the country. It is also a combination of two top competitors in their respective industries: satellite television and wireless phone service.

DIRECTV has a large national presence with 20 million video subscribers, second only to Comcast's 22 million subscribers.

AT&T is one of the Nation's top two wireless providers with 116 million subscribers. AT&T's video service, called "U-verse," has a more limited reach with 5.7 million subscribers, but it is the fastest-growing cable service in the country. AT&T also continues to grow its wireline and broadband business.

We are not here today to judge whether the merger is better for the bottom lines of these two companies or their shareholders. We will leave that to them and to Wall Street. We are here today to make sense of what this will mean for consumers—consumers who are feeling the squeeze as their cable, satellite, and broadband bills rise, consumers who want better and more choices for the type and amount of programming they are offered, and consumers who want more online video options.

The proposed combination of AT&T and DIRECTV in many respects appears to combine services that are largely complementary. AT&T has the broadband and wireless capabilities that DIRECTV lacks, and DIRECTV has a top-performing video service with the scale AT&T needs to lower its programming costs.

These points have merit, and AT&T's promise to expand its broadband reach, especially into rural areas, is a compelling aspect of this proposed deal. But our inquiry cannot stop there. We need to ensure that these benefits will not be outweighed by diminished competition or harm to consumers.

We know that robust competition keeps prices in check, incentivizes competitors to offer better choices and service, and promotes innovation. Yet this merger will result in some consumers losing a choice of video providers. AT&T and DIRECTV currently compete head to head in roughly 25 percent of the country, including large metro markets such as Chicago, Dallas, Los Angeles, San Francisco, and Atlanta. AT&T and DIRECTV say that together they will be able to offer a better bundle of Internet and video service to compete against cable company bundles.

But the fact remains that this merger will eliminate a competitive video provider, so we need to ask: What is the competitive dynamic in these markets? Will fewer competitors mean higher prices and lower-quality service? Will AT&T actually pass the cost savings they get from lower programming costs to consumers? And will AT&T have the incentive to continue to expand its competitive and fast-growing U-verse video service?

Consumers are also impacted by consolidation of pay-television providers because it means fewer outlets for independent programming. Will taking out one of the video distributors that writers and independent programmers have to pitch their new TV programs or channels to ensure consumers will have access to diverse programming? Both in this merger and the Comcast/Time-Warner Cable merger, we have heard concerns from the small independent content providers about the risks of consolidating down to just a few large video distributors.

Beyond the video market, AT&T is a dominant player in wireless phone service. Earlier I mentioned consumer demand for online video. People are consuming more and more video on their mobile phones. As this happens, video content will become an important commodity to wireless providers.

That brings us to an aspect of this deal that has sports fans talking, and they like to talk. Assuming DIRECTV renews its deal with the NFL, AT&T will have the rights to the NFL Sunday Ticket package. It has expressed a desire to be able to offer that programming to its wireless subscribers. How will AT&T's improved access to highly desirable content through its leverage of 26 million video subscribers impact the competitive landscape of the wireless market?

Finally, when discussing this merger, we cannot do so in a vacuum. The potential merger of AT&T and DIRECTV comes on the heels of the proposed combination of Comcast and Time Warner. These proposals have led to speculation that programmers, such as Viacom and CBS, will seek to merge.

Now, big is not automatically bad and can often be good in the right circumstances for economies of scale. But this consolidation poses a fundamental question: As broadband, video, and wireless markets begin to converge, what telecom ecosystem will best serve consumers both in the present and in the long term? What will be the tipping point when it comes to consolidation?

These are the kinds of questions our Subcommittee as well as the antitrust agencies ought to keep in mind when evaluating this merger and weighing what the future holds for consumers.

These are the types of issues we are going to be discussing this afternoon. We look forward to hearing from our witnesses, and now I turn it over to my Ranking Member, Senator Lee.

**OPENING STATEMENT OF HON. MICHAEL S. LEE,
A U.S. SENATOR FROM THE STATE OF UTAH**

Senator LEE. Thank you, Madam Chair. Today's hearing, of course, involves AT&T's recent announcement of its intention to acquire DIRECTV. AT&T and DIRECTV are well-known and very successful companies. AT&T is primarily a provider of mobile and fixed telephone, but it has in recent years made impressive inroads in the markets for video and high-speed Internet.

DIRECTV, on the other hand, is a satellite video provider. It has grown to become one of the largest multi-channel video programming distributors in the country with currently around 20 million subscribers.

The companies do not, for the most part, compete in the same markets. The primary products offered by these two companies are, for the most part, not substitutes but, rather, they are complements. Mergers of complements have the potential to create efficiencies that a merger of substitutes may not, and such transactions have traditionally been approved.

This merger has, nonetheless, attracted attention. The markets for video and Internet are extremely important to consumers, and this transaction is occurring just months after Comcast and Time Warner, two large players in the markets for video and Internet, announced their intention to combine.

In addition, AT&T and DIRECTV do offer substitute video products in some parts of the country, and the transaction has the potential to affect the competitive landscape in those areas.

As always, the guiding principle for our antitrust analysis is consumer welfare. Indeed, as Robert Bork wrote in "The Antitrust Paradox," "Competition must be understood as the maximization of consumer welfare."

In antitrust, as in other areas of public policymaking, competitors often stand to benefit from Government regulations or restrictions imposed on their rivals. As much as any other entity, competitors to merging parties have a constitutional right to petition and lobby the Government. They often have valuable information and insight into markets that will be affected by the proposed transaction at issue. And in many cases, competitors simply want to ensure that antitrust enforcers protect competition and ensure a level playing field.

At the same time, history and experience have taught us that competitors can and often do seek to use the antitrust process to gain an advantage for themselves. It is, therefore, essential that we remain on guard to ensure that the government process not be used to pick winners and losers in the marketplace. Where our policies and our approach to antitrust ensure that free markets operate effectively and consumers choose the winners and losers, we obtain the very best outcome for the country.

Applying these principles to this transaction will require a close look at those areas where the transaction may impact competition, such as where AT&T and DIRECTV currently compete for video subscribers. It requires scrutiny of the market for programming where consolidation is reducing the number of buyers of video content and may potentially impact the range of choice of content that may be available for consumers going forward.

This transaction's effect on the practice of bundling and the impact of that practice on consumers also merits some discussion. Proper antitrust principles, however, also require due weight to be given to the procompetitive ramifications of the proposed acquisition.

AT&T has committed to expand high-speed Internet access to some 15 million Americans who otherwise may not have such access. The market for high-speed Internet in some respects is both more important to consumers in the long term and suffers from less competition than the market for video. This deal may, thus, offer some real efficiencies and benefits to consumers, including innovation in a new Internet distribution technology—technology that might not obtain if the deal were blocked.

Markets, of course, change rapidly, and nowhere is this as true as it is for markets in technology-drive industries, such as voice, video, and Internet. In response to such changing circumstances and as we have seen with increase frequency of late, incumbent companies may seek to consolidate. In some cases this behavior may be part of a nefarious attempt to forestall change to prevent new products or new technologies from making an incumbent obsolete. In other cases, however, this kind of behavior simply represents intelligent business planning to adapt to and take advantage of new trends.

Accordingly, in fast-moving markets, consumers may be harmed by Government intervention just as easily as they may be harmed by consolidation. And it is essential that in considering important transactions, such as the one before us, we apply rigorous economic analysis and ground our conclusions in the evidence. By ensuring that we protect competition and not any individual company or competitor, we can help create market conditions that benefit consumers and promote economic development.

Thank you, Madam Chair.

Chairman KLOBUCHAR. Thank you very much, Senator Lee.

We are going to now start with our witnesses. I also want to thank Senator Blumenthal for being here. And I would like to introduce our distinguished witnesses.

Our first witness is Mr. Michael White. Mr. White is the president, chairman, and chief executive officer of DIRECTV. Before joining DIRECTV, he served in a number of management roles at Pepsi and as a private management consultant.

Our second witness is Mr. Randall Stephenson. Mr. Stephenson is the chairman and chief executive officer of AT&T. Previously he was AT&T's chief operating officer and a senior executive at Southwestern Bell Telephone Company.

Next we will hear from Mr. Christopher Keyser. Mr. Keyser is the president of the Writers of Guild of America, West. He has cre-

ated and worked on a number of popular television shows, including creating "Party of Five."

Do you watch that?

[Laughter.]

Chairman KLOBUCHAR. You do not have to answer.

Senator LEE. I do not. I am sorry.

Chairman KLOBUCHAR. It is still popular, though, just because he does not watch it. It is okay.

The next witness will be Mr. Matthew Wood. Mr. Wood is the policy director of Free Press. Prior to joining Free Press, Mr. Wood worked at the public interest law firm Media Access Project and in the communications practice groups of two private law firms in Washington, DC.

Then we will hear from Mr. Larry Downes. Mr. Downes is an Internet industry analyst and author. He is currently serving as the project director of the Evolution of Regulation and Innovation Project at the Georgetown Center for Business and Public Policy.

And our final witness will be Mr. Ross Lieberman. Mr. Lieberman is the senior vice president of government affairs for the American Cable Association, where he represents small- and medium-sized independent cable operators. He previously worked for EchoStar Communications, which is the parent company of Dish Network.

Thank you all for appearing at our Subcommittee's hearing to testify today. I now ask our witnesses to rise and raise their right hand as I administer the oath. Do you affirm that the testimony you are about to give before the Committee will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. WHITE. I do.

Mr. STEPHENSON. I do.

Mr. KEYSER. I do.

Mr. WOOD. I do.

Mr. DOWNES. I do.

Mr. LIEBERMAN. I do.

Chairman KLOBUCHAR. Thank you.

Okay. Why don't we begin with Mr. Michael White.

**STATEMENT OF MICHAEL WHITE, PRESIDENT, CHAIRMAN,
AND CHIEF EXECUTIVE OFFICER, DIRECTV, EL SEGUNDO,
CALIFORNIA**

Mr. WHITE. Thank you. Good afternoon, Chairwoman Klobuchar, Ranking Member Lee, and Members of the Subcommittee. My name is Mike White, and I am CEO of DIRECTV. Thank you for inviting me to testify on AT&T's proposed acquisition of DIRECTV.

For any business to succeed in the long term, it must satisfy its customers' needs better than the competition day in and day out, and this transaction will us at DIRECTV do exactly that. By combining complementary assets and products, we will be able to offer new services to our customers at a better value. We will help consumers watch the video they want, increasingly when they want it, and increasingly where they want it and on the many devices of their choice. And we will be well positioned to compete long into the future.

I would like to briefly describe DIRECTV's perspective on this transaction. Historically, DIRECTV is a remarkable American success story. We have competed aggressively, delivering more high-definition channels, a clearer sound and picture, more advanced equipment, and consistently better customer service than cable over the years. And, frankly, Congress has also had a lot to do with our success, making sure that we could acquire the programming our subscribers demanded, particularly in our early years.

In recent years, however, much has changed, particularly the growth of broadband. If we at DIRECTV want to continue to compete effectively in today's increasingly Internet-driven economy, we must adapt as well, in four ways:

First, we must provide an integrated bundle of services because consumers increasingly demand better bundles of both video and broadband. And, in fact, broadband is now the more important element of the two for many of our subscribers.

Second, we must serve those who want over-the-top offerings. Young subscribers in particular want services like YouTube, Netflix, and Hulu. And you need a broadband platform if we are to be able to meet that need as well in the future.

Third, we must continue to optimize our own video service as technology changes. Cable's two-way infrastructure lets it offer features such as remote DVRs and video-on-demand programming stored in the cloud. In fact, soon cable will offer other cloud-based features like lookback, and cable operators are increasingly leveraging the cloud to improve their service more quickly and easily. We, too, will need to do all of this if we intend to continue to compete and keep up.

And, finally, we will have to continue to effectively manage content cost increases. Rising content costs, far and away the largest element for any distributor, challenge all video providers. Yet bundled competitors can handle this somewhat better because they earn revenue from multiple services.

Historically we at DIRECTV have attempted to remain competitive by offering something called "synthetic bundles," in which the video and the broadband are provided by two separate companies but marketed together.

Synthetic bundles, however, make for a bad customer experience: customers have to talk to two sales representatives, wait for two different installation appointments, pay two separate bills, and make two calls every time they have a problem.

And synthetic bundles are also somewhat more expensive because each company seeks its own margin on its contribution to the bundled service.

We believe this transaction will help us meet all of these challenges head on. It combined DIRECTV's premier video assets with AT&T's unique broadband and wireless assets. It will mean better bundles. It will mean better video. It will mean lower content costs because of the additional value we can now offer programmers. And it means more and better broadband to 15 million new locations predominantly in rural areas. And, finally, it means more innovation, particularly as it relates to wireless video offerings.

If you put it all together, you get a transaction that lets us better serve our customers, unlock incremental growth opportunities that

will create jobs, and sustain our long-term competitiveness—a transaction, in other words, that opens up a world of new possibilities for DIRECTV's subscribers.

Thank you again for inviting me today, and I very much look forward to your questions.

[The prepared statement of Mr. White appears as a submission for the record.]

Chairman KLOBUCHAR. Thank you, Mr. White.

Mr. Stephenson.

STATEMENT OF RANDALL STEPHENSON, PRESIDENT, CHAIRMAN, AND CHIEF EXECUTIVE OFFICER, AT&T INC., DALLAS, TEXAS

Mr. STEPHENSON. Thank you, Chairman Klobuchar, Ranking Member Lee, and Members of the Committee. I am Randall Stephenson, chairman and CEO of AT&T, and I also appreciate the opportunity to visit with you about what we think are significant consumer and strategic benefits of the transaction.

This is unlike most mergers because it primarily combines companies with complementary products and capabilities—DIRECTV's pay-TV service and AT&T's broadband service—and the rationale for us coming together is really simple: it is about meeting consumer demand.

Customers are looking for bundles that combine TV and broadband service. That is because of the greater value and the convenience they get, and it is something that today they do get from our cable competitors nationwide.

Now, as Mike said, DIRECTV has the premier pay-TV service in the U.S., but it does not have a broadband network. And to effectively compete against cable for broadband customers, AT&T markets bundles of services, mostly broadband and TV, even though our video service is not profitable. In fact, fewer than 140,000 of our TV customers—that is less than 2 percent of them—purchase TV service on a stand-alone basis. We do not actively market stand-alone video because we do not make any money on it.

Today 60 cents of every video dollar we earn goes straight to the programmers. In addition, we can offer video in only a small portion of the country, less than a quarter of U.S. households, and we do not even cover all of the broadband footprint that we have built. And that is due to technology and economic limitations.

As a result, there is no significant competitive overlap between AT&T and DIRECTV in the products that consumers are overwhelmingly demanding today, and that is a broadband video bundle. The consumer benefits of this transaction are significant. Being able to offer DIRECTV nationwide is a game changer as it relates to the economics of deploying broadband. It will allow us to expand and enhance broadband service to at least 15 million locations across 48 States, mostly those in rural areas. This is in addition to the broadband expansion plans that we have already announced, and it directly results from the synergies created by the transaction. This new broadband commitment includes 13 million rural locations, 85 percent of which are outside of our traditional fixed-line footprint.

We think this is really big news for rural America. We estimate that nearly 20 percent of these consumers today have no access to wireline broadband service and that another 27 percent are hostage to only one provider. For many of these 13 million consumers, AT&T's service will be the fastest service available, and for some it will be their first chance for truly high-speed broadband.

The transaction also allows us to expand our one-gigabit service to 2 million additional locations, so all told, we will be able to serve 70 million customer locations with broadband. This transaction will allow us to price more competitively and provide consumers a higher-quality experience, which in turn will result in cable companies' pricing more competitively as well in all their products.

Consumers will receive greater convenience with a single point of contact for ordering, installation, billing, and care. We will be able to accelerate the development of new over-the-top video services offered by AT&T and Netflix and Amazon and Hulu and so many others, and deliver them to any screen. This is the exciting part. It can go to a mobile phone, computers, tablets, cars. We are even working on delivery to airplanes.

We operate in a competitive environment that is only becoming more competitive. The cable companies already dominate both broadband and video, and Google Fiber, Netflix, and even faster wireless services are transforming the competition daily.

This transaction gives AT&T the capabilities to be a more effective competitor to cable, and I want to assure the Committee and I want to assure our customers as well that we will do these things while meeting or exceeding the FCC's net neutrality standards and extending our best-in-class diversity and labor practices to the employees and suppliers of the combined company.

So again, thank you for the opportunity, and I look forward to your questions.

[The prepared statement of Randall Stephenson appears as a submission for the record.]

Chairman KLOBUCHAR. Thank you very much, Mr. Stephenson, we also discovered up here that you wrote for "L.A. Law," and he had seen that one.

[Laughter.]

Chairman KLOBUCHAR. I just wanted to make you feel better.

**STATEMENT OF CHRISTOPHER KEYSER, PRESIDENT,
WRITERS GUILD OF AMERICA, WEST, INC., LOS ANGELES,
CALIFORNIA**

Mr. KEYSER. Chairman Klobuchar, Ranking Member Lee, I forgive you for not being a fan of my work. You are not alone. Members of the Subcommittee—

Senator LEE. I want to be clear I am sure it is a great show.

Mr. KEYSER. Thank you for the opportunity to appear before you today. My name is Christopher Keyser, and I am the president of the Writers Guild of America, West. I have been a working television writer, as you said, for 25 years.

On behalf of my guild, I have come here today to speak against the AT&T/DIRECTV merger, and because I cannot help myself, here is a story.

The writers I represent, more than 8,000 of them, and the members of our sister guild, the Writers Guild of America, East, write feature films and local news. But what matters in this conversation is that we also create virtually all of the scripted programming that you watch on television now or through video services such as Netflix and Amazon, and that will become important in a minute.

That programming is at this moment the most influential creative product in the country and indeed in the world. Nothing has the power and the reach of television.

But two decades of mergers and consolidation have reduced a once vibrant market of diverse and independent production to the point where now seven companies own 95 percent of what you watch on TV. Networks and studios have become one. They control both content and delivery. They determine what I am allowed to write and what you are allowed to watch.

Into that world only recently has come the Internet, and suddenly the Internet has opened up a possibility of enormous new content and creativity, a host of new voices, new content creators, new distributors. Potentially this is the most exciting time for audiences and writers, anyone who cares about diversity and the vibrancy of the creative output of this country. It is a very American thing, which brings us back to the merger.

It is no accident that a flurry of mergers is occurring in response to the potential democratization of the entertainment industry. The largest multi-channel video programming distributors and Internet service providers have every reason to fear and every incentive to limit the growth of online video competition that could threaten its dominance.

If this merger and the Comcast merger are approved, the two resulting companies will control more than half of the MVPD subscribers and half of the wired Internet access market. They will have unprecedented power to control the content that passes to you.

So what do we know that will happen as a result? Well, we know, because they have said so, that they will use their power to force content providers to accept below-market rates for their product. It is a stated goal of the merger to reduce affiliate fees.

So the problem is that these fees have fueled the recent boom in creative programming, particularly on cable, and reduced those fees through the outside power of monopoly, and the result is less creativity, less product, and less innovation.

The second thing we should fear and of which we can be virtually certain is that a combined AT&T/DIRECTV will follow in the footsteps of Comcast and use its power to discriminate against unaffiliated video content providers. AT&T has already said that it is in favor of paid prioritization, because when you control access to 50 percent of consumers, those who want to deliver their products are so beholden to you that they cannot afford to refuse your conditions. And those who cannot or do not pay will find their products metaphorically on the hidden shelves in the back corner of the store.

Because the power to control the pipeline actually trumps the power to create, it brings with it the power to undermine the revo-

lutionary quality of the Internet itself, and that is precisely the issue the FCC is dealing with today.

The one thing we know as writers is that character is destiny, and the character of these companies is not in doubt. You do not gain access to half of the market without prioritizing your shareholders over the American people.

As Comcast/Time Warner begat AT&T/DIRECTV, so, too, will this merger beget more consolidation in response. And then the merger of content creators, desperate for leverage against two powerful distributors, will come in time. They are already in the air. Eventually these behemoths of video distribution will seek, as every incumbent media giant has before in history, to own its own content or to produce—or to buy other content providers. And the Internet, which might have been a new frontier, will become like broadcast television before it. And those of us who write for a living, who love stories and the vibrant marketplace of ideas, who believe that a culture is defined at least in part by the quality of the art it creates, who believe in the American ideal of limitless voices, will mourn a missed opportunity.

We have seen this story before. We begin it again today, and we may believe, or some may tell you, that this time we can change the ending. But as a writer, I know this much. If you put the butler in line to inherit and you give him a candlestick in the drawing room, someone is going to end up dead by the last act.

I have come here today to ask that regulators make the right choice, one that serves the public interest, and deny these mergers.

Thank you for your attention. I look forward to your questions. [The prepared statement of Christopher Keyser appears as a submission for the record.]

Chairman KLOBUCHAR. Very good. Thank you.
Mr. Matthew Wood.

**STATEMENT OF MATTHEW F. WOOD, POLICY
DIRECTOR, FREE PRESS, WASHINGTON, DC**

Mr. WOOD. Good afternoon, Chairman Klobuchar, Ranking Member Lee, and esteemed Members of the Subcommittee. Thank you for having me back to talk about this merger and what it means for video and broadband competition and consumers.

Free Press works for open, universal, and affordable Internet access. To do that, we also keep a watchful eye on consolidation in media and telecom, and we have had an eyeful lately with all the deals that are pending or in the works.

There is no good reason for any of these mega mergers, including this combination of DIRECTV, the Nation's second largest video provider, with AT&T. It is just more concentration, less competition, and the same old promises used to sell these bad deals to the public. Each time it goes shopping, AT&T comes before you hoping you are ready to believe almost anything and that you have a very short memory.

How else to explain AT&T's counterintuitive claim that eliminating competitors somehow leads to more competition? How else to explain so-called merger-specific benefits that actually have nothing to do with the merger and provide no real benefits?

AT&T has made the same promises for deals stretching back over the past decade. It is better at making promises than keeping them. This deal would give us what the Department of Justice calls “highly concentrated markets” everywhere AT&T offers pay TV. Going from four choices down to three where AT&T offers video today is not a net win, no matter how AT&T spins it.

If this all sounds familiar, it should. Three years ago, you also heard that taking out a wireless rival would increase competition. AT&T said T-Mobile was not a real competitive threat anymore. It said AT&T could not invest in rural America without that merger. Those claims are no more convincing today than they were then, and the numbers here, as measured by DOJ, are even worse.

There are 64 TV markets where nearly all of AT&T’s video subscribers reside. All 64 would be highly concentrated after this deal. Antitrust authorities say such mergers are likely to “raise prices, reduce output, diminish innovation, and otherwise harm customers.”

AT&T counters that it would save costs on video programming. Yet while AT&T may lower its own costs by acquiring more scale, analysts believe the company is overstating those savings. And no matter how big they are, there is no guarantee and really no likelihood that AT&T would pass these savings along to its customer.

Search high and low through the deal descriptions that AT&T has filed this month, and if they wanted to make a promise to reduce prices, they could have done so in simple and uncertain terms. They did not.

Instead, AT&T says that over-the-top video keeps prices in check, but ignores the control that broadband providers have over these online services. And while a growing number of consumers are cutting the cord on pay TV, that number is still small compared to the number of pay-TV subscribers that remain.

AT&T also argues that DIRECTV is not a real competitor because customers only want bundles today. But the idea that this deal would let AT&T compete more vigorously against bundled cable services is not borne out by the facts. For one thing, customers want choices not forced bundles to make them buy services they do not want. And AT&T and DIRECTV already partner to sell bundles today, the synthetic bundles you have heard about from the other witnesses. But AT&T charges DIRECTV customers more than twice as much for broadband in those packages as it charges its own U-verse TV customers. If we had working markets and reasonable resale policies, we could promote competition and let people choose their bundles, too.

With nothing else to offer, AT&T recycles its past promises, stretching past that failed T-Mobile merger in 2011 to Bell South in 2006, saying mergers let it provide more and better broadband. It has not always kept these promises. It has just kept people waiting. And AT&T never explains adequately how these new assurances add anything to its prior commitments and deployment plans. It says it will expand broadband at 15 million customer locations after this deal, but 13 million of those get fixed wireless.

Forget for a moment that this wireless products promised for rural America is inferior. Forget that AT&T told consumers last month that wireless service was already available nationwide.

AT&T could provide a serious broadband upgrade if it would stop making airy promises and just invest.

Between the cash, stock, and debt, AT&T would spend nearly \$70 billion to acquire DIRECTV. This is wasteful capital allocation plain and simple, because AT&T could spend that money to triple the size of its current fiber footprint, signing up more video subscribers than DIRECTV has today in the process.

AT&T may believe that you have forgotten the last time you heard these promises, but I do not think that you have. You know to look under the hood and not buy a used car based on the new paint job alone. So if you hear the only way to promote competition is to kill it, you wonder how that could be true. If you hear that we need less video competition to get more broadband, you wonder why. And if you hear the same company promising better broadband is just around the corner, always just one more merger away, you wonder when. When will AT&T stop throwing money at mergers and start investing for real?

Thank you very much, and I look forward to your questions.

[The prepared statement of Matthew F. Wood appears as a submission for the record.]

Chairman KLOBUCHAR. Thank you, Mr. Wood.

Mr. Larry Downes.

**STATEMENT OF LARRY DOWNES, PROJECT DIRECTOR,
GEORGETOWN UNIVERSITY, CENTER FOR BUSINESS AND
PUBLIC POLICY, WASHINGTON, DC**

Mr. DOWNES. Chairman Klobuchar, Ranking Member Lee and Members of the Committee, thank you for this opportunity to testify.

My name is Larry Downes. Based in Silicon Valley for the last 20 years, I am an Internet industry veteran and the author of several books on the information economy, innovation, and the impact of regulation.

But for the past 3 years, I have been involved in a research project focused on the changing nature of technology, market disruption, and competition performed in conjunction with the Accenture Institute for High Performance. Our recently published findings demonstrate that technological and market forces have put unprecedented and accelerating pressures on incumbent businesses, especially those subject to a long history of regulatory oversight.

Like many of the industries we studied, the video marketplace is in the midst of a profound and exciting transformation—at least for consumers and entrepreneurs. For both AT&T and DIRECTV, on the other hand, that transformation poses a daunting triple play of threats to their current business model:

Number one, the rise of a few very powerful content and distribution companies, including Disney, Fox, and CBS, have weighed the scales in program carriage and other negotiations strongly on the side of the programmers, bloating channel bundles and raising prices for consumers even as many users demand more a la carte solutions.

Number two, hundreds of largely unregulated, Internet-based content providers, including Google, Amazon, Apple, Aereo and

Netflix, are experimenting wildly with new technologies and new business models for producing, collecting, distributing, and monetizing a cornucopia of new and old programming.

Number three, in developing strategies both to compete and cooperate with these and other threats, AT&T and DIRECTV are severely constrained by decades of policy compromises designed to resolve earlier conflicts between old business models and new technologies. Taken together, they form a sclerotic tangle of interconnected, contradictory, and in many cases counterproductive limits on the ability of both companies to adapt to the accelerating pace of change, often for reasons that no longer serve any public interest.

I want to say a little bit more about all three of these, which I discuss in detail in my written testimony. But first let us acknowledge that the true driver of change in the media market and the real source of competitive pressure is the exploding availability of increasingly better and cheaper core technology components—the principle known as Moore’s Law.

Innately familiar with the faster, cheaper, smaller promise of Moore’s Law, consumers now demand access to the full range of content anytime, anywhere, and on whatever device they happen to be nearest. And with the continued deflation of component costs, that content and the networks to deliver it will continue to evolve from today’s high-definition standard to 4K or ultra-high definition and to future innovations.

This ongoing disruptive innovation means that predicting future consumer demand has become largely impossible. Preferred forms of bundling and pricing have splintered with each user demanding their own unique configuration, one that will change on a whim.

Already held back by the anchor of a growing regulatory burden, new business pressures on regulated multi-channel video programming distributors are now arriving separately and together from two principal disruptors: mushrooming programming costs and the explosion of largely unregulated over-the-top video services. And while the FCC finds that the average price per channel has declined the number of channels continues to expand on average from 44 to 150 since 1995. Premium channels are often used as bargaining chips to promote less popular content. Cable customers pay as much as \$6 a month just to cover the cost of ESPN, whether they watch it or not.

The net result is rising prices for consumers, increasing their incentive to cut the cord to MVPD services and look for alternatives. Right on cue, unregulated over-the-top content providers are experimenting with abandon, finding new ways to produce, collect, distribute, and monetize old and new programming. Netflix alone has more than 30 million customers in the U.S., and like other OTT providers, has begun producing its own premium proprietary content.

Falling costs for core computing technology also means consumers themselves now contribute significantly to the bounty of new content and access choices. Users upload 100 hours of new video every minute just to YouTube, and many user channels have millions of viewers. Crowdfunding sites are flooded with proposals for content production, many of which are oversubscribed.

These new models are thriving because consumers want more options than the current regulated industry structure makes possible, or at least at the clock speed of Moore's Law.

Thus, I see the proposed transaction as a largely defensive move, one that makes sound strategic sense. To remain competitive, AT&T needs the audience DIRECTV has already built. U-verse needs larger audiences to improve its bargaining position with programmers and to achieve economies of scale for the content it licenses.

DIRECTV, likewise, needs the broadband network AT&T has built, and to participate in, let alone compete with, the expanding universe of OTT services, DIRECTV quickly requires the native ability to integrate broadband Internet with produced content. With a native broadband offering, DIRECTV will remain a viable competitor, enforcing market discipline on cable-based, satellite, and other MVPDs. This transaction presents few, if any, of the traditional markers for concern, either under antitrust law or the FCC's public interest standard. The result should be more competitive pressure, both within the supply chain and in the market as a whole.

I thank you again for the opportunity to testify, and I look forward to your questions.

[The prepared statement of Larry Downes appears as a submission for the record.]

Chairman KLOBUCHAR. Thank you very much, Mr. Downes.
Mr. Lieberman, welcome back.

**STATEMENT OF ROSS J. LIEBERMAN, SENIOR VICE
PRESIDENT OF GOVERNMENT AFFAIRS, AMERICAN CABLE
ASSOCIATION, WASHINGTON, DC**

Mr. LIEBERMAN. Thank you. An unprecedented wave of consolidation is occurring within the video programming and distribution industries that will transform the competitive market and consumer experience. This is cause for concern. Congress and regulators, therefore, must not only review pending deals; it must also examine and act to address the underlying market problems fueling them.

Focusing on AT&T's deal, it is important to realize DIRECTV is not only a nationwide paid-TV provider, it is also a programmer, with interests in three regional sports networks and national programming. This gives DIRECTV an economic incentive and ability to charge its rivals higher fees for its programming, especially its regional sports networks.

Smaller cable operators are concerned that this deal will lead DIRECTV's programmers to hold out for even higher rates. With 26 million subscribers, AT&T and DIRECTV combined will command better programming deals than DIRECTV would alone. This means higher video profits for both DIRECTV and U-verse services.

Regulators have accepted that as the per video subscriber profits of a vertically integrated pay-TV provider rise, so does its interest in boosting its rivals' costs for its programming. Accordingly, pay-TV providers will feel the pinch when negotiating for DIRECTV's programming, and their customers will pay.

Regulators should not approve the merger without addressing this matter. While DIRECTV remains subject to program access rules, as an FCC condition from a prior deal, it is no longer subject to an arbitration condition. However, readopting this same arbitration condition is not enough. It had design flaws that left smaller cable operators underprotected. To shield these operators fully, these defects must be eliminated.

Congress and regulators must also look at the bigger picture by reviewing existing rules to ensure that industrywide problems, particularly those driving consolidation, are addressed. This will ensure consumers continue to benefit from a competitive pay-TV marketplace that includes smaller operators.

ACA members have long raised alarms about large broadcasters' and programmers' increasing rates and carriage demands and their discriminatory pricing practices. The programming costs for a smaller cable operator is significantly higher than for a larger provider. The spread, thought to average around 30 percent, puts ACA members at a substantial disadvantage to bigger competitors like DIRECTV, Dish Network, and Comcast.

AT&T's desire to acquire DIRECTV does not surprise smaller cable operators. Even though AT&T's subscriber base nearly exceeds that of all smaller cable operators combined, its modus for buying DIRECTV point to it facing similar market problems. Like ACA's members, AT&T also understands its competitive standing is likely to worsen if the Comcast-Time Warner Cable and Comcast-Charter deals are approved.

While AT&T can lower its programming costs and better compete by buying DIRECTV, smaller cable operators cannot because they lack AT&T's financial scale. Unable to spend their way out of trouble, these video providers will struggle to remain viable.

Some critics of AT&T's deal raise concerns about the number of pay-TV providers decreasing from four to three in U-verse territories. In rural areas, where three video service providers typically exist, programming cost issues have driven some smaller cable operators to closed systems, leaving consumers with only two satellite TV providers.

Although the slow but steady decrease in competition in rural areas has not yet generated much concern from Washington, it should, because it is harmful to rural America and often signals wider market problems.

These trends are not irreversible. Congress and regulators can take action to prevent ACA members and their customers from simply being unreasonably disadvantaged compared to their larger competitors.

In conclusion, there are three areas where oversight and action would be meaningful: first, by examining and addressing programmers' discriminatory pricing practices against smaller pay-TV providers; second, by modernizing program access rules by updating the FCC's definition of a buy-in group, which is the way smaller operators buy programming; and, third, by updating the FCC's outdated regulatory fee categories so all pay-TV providers, including DIRECTV and Dish, pay their fair share.

Thank you, and I look forward to your questions.

[The prepared statement of Ross J. Lieberman appears as a submission for the record.]

Chairman KLOBUCHAR. Thank you very much.

We will start with you, Mr. Stephenson. You noted in your statement that the merger presents no significant competition overlap. Do you consider DIRECTV to be a competitor in the markets where you do overlap? I think it is something like 30 million consumers and 25 percent of the country.

Mr. STEPHENSON. To your point, 75 percent of the country, we do not compete. In 25 percent of the country, we do have a network that can deliver video. As I mentioned in my comments, we do not actively market a stand-alone video product, which is what DIRECTV sells. We lose money on video. So what we do is bundle video with broadband. Video is the vehicle by which we sell and market broadband, quite candidly. And so if you look at our customer base of video, 5.7 million, less than 140,000 of those are what we would call "stand-alone video customers," the type of customers that Mike pursues in the marketplace.

So our video footprint does overlap 25 percent of the U.S., but we are a bundle provider. We sell bundles of broadband and video, and we sell video only to facilitate selling broadband.

Chairman KLOBUCHAR. Mr. White, just 3 months ago, you said that half of America has "a very robust telco competitor" to your service, and we know that AT&T is one of the country's major telephone companies. In November, you said this was a highly competitive industry and that that has certainly gotten more true with the telcos entering the business and being very aggressive. Finally, last August, you said the biggest chunk of your new subscribers are former cable and telco consumers.

So do you see this overlap of competition? Are you concerned? Do you think that there should be concern for those consumers?

Mr. WHITE. Well, certainly if you take both Verizon and AT&T and you add up the homes passed, I guess you get about 50 million homes, so that is kind of half of America, a little bit less than half of America, I would guess, that there are homes passed. But as Randall said, they are fairly small at 5 million-plus subscribers right now. So certainly in those overlap areas, there are—you have to look at the pluses and the minuses. And, again, I would start with—in any deal, you have to look at the total picture. In our case, in the 75 percent of America where we do not compete, there is a significant benefit to consumers of 15 million homes that will get better broadband. In addition, DIRECTV will be a stronger competitor because we will be able to market broadband bundles to 38 million homes outside of where we compete.

In the areas where we compete, I also would argue that the consumer is going to get better choice, because today DIRECTV does not have a seamless bundle in those markets, and by the same token, AT&T is constrained as to how aggressively they can compete because of their high cost of content.

Chairman KLOBUCHAR. One of the things that people are really focused on—and certainly we asked a lot of questions in the last hearing on the Comcast merger—is what is going to happen with the prices for consumers. And in your written testimony, Mr. Stephenson, the only mention of prices about this transaction is that

it will “allow us to price all of our services more competitively.” What does that mean? Does this mean that consumers will actually see less costly service? Or does it just mean there is going to be downward pressure? And that is what we are trying to figure out here, what this means for consumers.

Mr. STEPHENSON. Yes, we use that terminology “downward pressure” for a simple reason. The largest cost component in the video business is content programming. As I said in my opening comments, for every dollar we bill for video, 60 cents goes out the door to the programmers before we buy set-top boxes and do customer care and send a bill and roll a truck out to provision the service.

So what drives prices in this industry are content costs, and content costs for all of us are growing roughly 8 percent per year, and we are raising rates about half that pace to try to keep up with the content costs.

As we put these two companies together, one of the primary benefits of it is we create a very, very compelling opportunity for the content providers. We have a larger video footprint. Mike has some very deep relationships with programmers. We believe the AT&T content costs will begin—and we feel very strongly—to look more like the DIRECTV content costs.

Chairman KLOBUCHAR. But does that mean that consumers will see the price decrease?

Mr. STEPHENSON. So in a highly competitive environment like video and broadband, when you have margin, the margin typically gets competed away. And so when we modeled this—we actually brought in an economist who used to serve at the DOJ to model this thing for us. His modeling says even before you get to the programming synergies, the bias ought to be downward on pricing. There will be downward pricing pressure not just for us but for the cable providers as well. There will be downward pricing pressure on both their bundles, their stand-alone video, and stand-alone broadband products.

Chairman KLOBUCHAR. And if you see this downward pricing, will the U-verse customers for whom AT&T, as you have noted, pays higher programming costs, will they realize the benefit, or do you think it will be spread in cost savings out among video, including DIRECTV customers? The cost savings?

Mr. STEPHENSON. The what?

Chairman KLOBUCHAR. The cost savings that you are going to see, are they just going to go to those U-verse customers, or are they going to be spread across all the customers?

Mr. STEPHENSON. There are going to be a lot of cost savings outside of programming. For example, we roll—when Mike sells a synthetic bundle today, he rolls a truck to the house; we roll a truck to the house. Mike sends a bill; we send a bill. When a customer has a care problem, they call one—two numbers. When you put the two companies together, it will be one truck roll, it will be one bill, it will be one sales call, and so forth.

So there are a number of synergies and savings that will go forward as a result of this.

Chairman KLOBUCHAR. Mr. Wood, do you see it a different way?

Mr. WOOD. It does not sound like these synthetic bundles have been all that well synthesized in some ways because with resale

you could have a single company taking care of the customer. And as I note in my written testimony, it is actually \$34 a month when you buy AT&T broadband through DIRECTV and \$14 a month—14 and change—for that same product to an AT&T customer.

So we think that the bundling is obviously a benefit to some if people want to bundle, but the benefits of combining the two companies outweigh—or are overstated and outweighed by the dangers of the harm to competition here.

Chairman KLOBUCHAR. All right. We have been talking about the importance to consumers of price competition and what the loss of a competitor would mean, but I want to quickly turn to programming. DIRECTV has and is currently renegotiating the rights to NFL Sunday Ticket, which has every out-of-market NFL Sunday game. Some commentators have said that this merger is all about Sunday Ticket as opposed to some of the people that Mr. Keyser represents.

Does NFL Sunday Ticket, Mr. White, help you differentiate your product and compete with cable companies and telephone companies?

Mr. WHITE. Yes, it does. We have had a 20-year relationship this year with the NFL. We both, I think, benefited by that relationship. Our contract expires after this coming season, so we are in discussions about extending that contract. And we are very optimistic and hopeful that we will be able to do that. We have an excellent relationship with the NFL.

Chairman KLOBUCHAR. And, Mr. Stephenson, your merger is contingent on DIRECTV renewing its contract with the NFL for Sunday ticket. Is that right?

Mr. STEPHENSON. Yes, that is correct.

Chairman KLOBUCHAR. And what are your plans? Would AT&T seek to expand the reach of Sunday Ticket to its wireless platform?

Mr. STEPHENSON. So DIRECTV in the current agreement has the rights for their Sunday Ticket subscribers to distribute that content to their mobile devices, and when we have, you know, 100 million mobile subscribers, we would envision taking advantage of that situation and allowing our customers who also subscribe to the Sunday Ticket to access that on any device anywhere, anytime they wanted.

Chairman KLOBUCHAR. Okay. Anyone else have a different view of—okay. Mr. Lieberman, one last question on the sports, and then in my next round, I will ask you a few questions here, Mr. Keyser.

DIRECTV owns three regional sports networks in Pittsburgh, the Rocky Mountain region, and the Pacific Northwest. How does ownership of regional sports networks by DIRECTV or any other distributor impact competition? Do you think the DOJ and FCC, if they approve the merger, should consider conditions regarding regional sports network ownership?

Mr. LIEBERMAN. Thanks for the question. When a pay-TV provider owns programming, they have an incentive and ability to charge higher prices to their rivals. This has been a conclusion that has been reached in many transactions in the past, ones involving DIRECTV, ones involving Comcast. This is going to be a situation that will happen in this deal as well, as a result of DIRECTV owning the regional sports networks, as you note.

Smaller cable operators carry this programming. They are concerned about their prices for that programming going up, so it is important that as part of this deal that the FCC readopt conditions, the way it has been addressed before is through arbitration conditions, to address this harm.

Chairman KLOBUCHAR. All right. Thank you very much.

Mr. Lee.

Senator LEE. Thank you, Madam Chair.

Mr. Stephenson, the antitrust agencies' 2010 horizontal merger guidelines confirm an important part of any antitrust analysis involves inquiring into the potential efficiencies that the proposed transaction might deliver, that it might produce or create? The guidelines state that the agencies will credit these merger-specific efficiencies only if they are merger-specific; that is to say, if and only if they will occur as a result of the merger and that they would not occur in the absence of the merger, or in the absence of some other event comparable to the merger in terms of any anti-competitive effects the merger might have.

And so my question for us is: What procompetitive efficiencies do you see associated with this merger? And could those efficiencies be achieved in the absence of the merger?

Mr. STEPHENSON. The primary efficiency that we have talked about are the efficiencies from buying programming, content, and we expressed to the street an objective of achieving \$1.6 billion per year reduced costs within 3 years, obviously the lion's share of that being from the programming efficiencies. The other efficiencies are what I discussed previously: one truck roll when we provision service, one bill, one customer care call, one sales call. And we have a history of putting these types of efficiencies into the marketplace and telling our owners our objectives. We have, I believe, a spotless record of achieving those efficiencies.

So we believe the \$1.6 billion run rate number is a very achievable number, feel highly confident that we will hit that number.

Senator LEE. And that part is just from the programming?

Mr. STEPHENSON. That is largely the programming. The other part is from one truck roll to the house, one bill, one customer care call, et cetera. And then—

Senator LEE. And really quickly on that, what is your response to Mr. Wood's point about the fact that if you synthesize the synthetic agreements better, you could achieve the same thing without the merger?

Mr. STEPHENSON. It is really easy to say. It comes off the tongue really easily. Mike and I have tried this for a number of years, and we have worked it really hard. I have tried it with Dish satellite before, and it is a very difficult thing to accomplish for the simple reason that we do expect to make money off our broadband products; he expects to make money off his TV product. So you start to stack margins for the customer.

And what happens when you put the two companies together, you gain the efficiencies. It allows you to pull that margin stacking out and the customer benefits. At the end of the day, you have a more elegant, seamless IT process, care process. It is just a more elegant way of doing it.

Senator LEE. I interrupted you a minute ago. You were making a second point.

Mr. STEPHENSON. Yes, there is another major efficiency and benefit that comes from this transaction, and that is, as I mentioned in the beginning, we lose money on video. As we move our programming costs to look more like DIRECTV's programming costs, it changes the dynamic of our video product. We suddenly go from video being a loser to a profitable service. And now our broadband build is not burdened by a money-losing proposition on video.

What that allows us to do is to think differently about broadband investment. We have the technology—we have been working a long time—that we would like to use to roll broadband out to rural America. It is wireless based. It gets called “inferior.” It is superior to virtually anything that is out there in these rural communities today. And when you put a profitable video product attached to this capability, this wireless technology, it is going to allow us to build broadband, 15 to 20 megabits per second capability, to 13 million additional customer locations in rural America across 48 States. We think that is exciting. We think it is an exciting opportunity for rural America.

It also changes the economics of our fiber build where we are deploying fiber to the home. We have a significant build in progress right now that we are consummating. We are going to add 2 million more homes passed because of the economics, how they change on this.

Senator LEE. This broadband, this is with existing bandwidth you have already got, this does not require an additional acquisition of bandwidth?

Mr. STEPHENSON. The places where we are deploying this, and the reason rural is so beneficial is because rural is the place where it is not congested, so we have 20 megahertz of wireless spectrum that we can put to use with this product now.

Senator LEE. Okay. Mr. Downes, in your testimony you referred to the role of Big Bang disruption in the video market. Can you give us some examples of this, of how Big Bang disruption has impacted markets in the past and explain why you think this might have some relevance here?

Mr. DOWNES. Sure. Thank you, Senator. There is an old model of how you think about innovation and disruption, and this was that new products would enter the market, they would be worse but cheaper, and that that meant that the incumbents had time to respond and to incorporate those new technologies over a long period of time. And what we found is that sort of, you know, 50 years on now of Moore's Law making computers and a lot of other components better and cheaper, it now comes that new products often enter the market both better and cheaper at the same time. One of the examples we used was GPS devices and how they were disrupted by apps on smartphones that did the exact same thing better and in that case free, so much, much cheaper.

And this is happening, it has been happening certainly in communications, in computing, in the entertainment industry for a long time. It is now moving into other industries. You know, you can now embed computing onto pretty much anything at an ex-

tremely low cost because it is small, it does not use much power, and the components are increasingly very, very cheap.

This I think is what has really driven the massive amount of innovation that happened with over-the-top services. The over-the-top services are great, and it is not just these big companies, not just Netflix and Hulu. It is individuals creating their own channel and being able to distribute that channel. They can produce the content much more cheaply, get high-quality content, even scripted content, and be able to deliver that over the Internet at just much, much lower cost. That opens up the opportunity for a lot of innovation, and it completely, frankly, catches the incumbents offside because they are waiting for the worst but cheaper alternative, and it never showed up. It was the better and cheaper alternative that happened to them.

Senator LEE. In the seconds I have left, Mr. Wood, do you want to respond to Mr. Stephenson's response to your statement?

Mr. WOOD. Senator, I was actually thinking about Mr. Downes' question and response, which was that this Big Bang innovation, we certainly have an explosion of over-the-top innovation now, but it is all flowing over the wires and wireless spectrum that AT&T control. So I think that that is what we have to take into account when we hear that over-the-top video is an answer. It is an answer, but it is not an answer to the lack of competition we see in broadband and facilities-based TV.

And I am sorry, sir, I would be happy to address Mr. Stephenson's points if you have other questions about those, but I am not sure which part of those you are after.

Senator LEE. So his response to your point about the trucks. You believe that it was not—the synthetic mergers, the synthetic bundles were not efficient because, as you put it, they did not synthesize them correctly.

Mr. WOOD. Right. I mean, I think that, again, with a reasonable and nondiscriminatory resale market where companies could actually have a single truck roll perhaps or a single bill, the margin stacking you are hearing about maybe would not be a problem. And at the end—and in response to Senator Klobuchar's statement, too, you do not hear them saying that there will actually be lower prices as a result of this. They talk about downward pressure and economic theory. But what they are really saying is we will have better margins perhaps for our business, we will have lower costs. There is no indication that, even if those savings are real, they will actually be passed along to customers in any meaningful way.

Senator LEE. Okay. I will want to followup on that later, but the Chair wields a gavel, and I do not want to—

Chairman KLOBUCHAR. There we are. Okay. Or a candlestick, as Mr. Keyser would say.

[Laughter.]

Chairman KLOBUCHAR. Okay. Senator Blumenthal.

Senator BLUMENTHAL. Thank you, Madam Chairman. I am not going to compare candlesticks to gavels.

Chairman KLOBUCHAR. We could have a whole Clue game going on with Mr. White as opposed to Mrs. White, but we are not going to go there.

[Laughter.]

Senator BLUMENTHAL. I hope this exchange does not detract from my time.

Chairman KLOBUCHAR. No, it does not at all. Start afresh.

Senator FRANKEN. I think it should.

[Laughter.]

Senator BLUMENTHAL. Without any disrespect to Senator Franken, I am going to play the part of the ordinary consumer, and I have great respect for both of your companies and your sincerity in the beliefs and the projections you have made about what is going to be accomplished by this merger. But if I am the ordinary consumer, I am rolling my eyes, because I have seen this show before. In the communications landscape, I have seen mergers, consolidation, and most importantly, inexorably, relentlessly rising cable rates.

So I am very, very skeptical as a Senator, not just as a consumer, because you are asking us to make two gigantic leaps of faith: number one, that you are going to be able to achieve cost savings by driving down the cost of content, and you have testified very powerfully that content costs are rising; and, number two, that those cost savings are actually going to be passed along to consumers.

So let me begin with the first. As you know, about content, even giants like Comcast and Time Warner have continued to see rising costs in their content, and they have been unable to achieve the cost savings that you are projecting. Tell me what you are going to do to drive down the costs of content when, just looking at the cost of sports, 17 percent of a cable company's programming costs, today sports represent 38 percent of a total bill for purchasing content, and the L.A. Times recently found that sports channels represent more than 50 percent of the monthly cable bill, and those sports programming costs are rising inexorably. So what specifically can you do?

Mr. STEPHENSON. I am going to start, and then I will let Mike tag on. But the first part of it, Senator, is somewhat mechanical, and that is, we have 5.7 million customers on the AT&T U-verse platform that are paying significantly higher content costs than DIRECTV is, and the lion's share of the content cost savings is not necessarily that we are going to drive down DIRECTV's programming costs. But the AT&T programming costs will look like DIRECTV's over time. We feel fairly confident in that. So what that will do——

Senator BLUMENTHAL. You feel fairly confident? Can you commit to us that you know it will be true? Do you have——

Mr. STEPHENSON. It has got to be negotiated, and we are negotiating with some very good business people who have very good business models and they are tough negotiators. But, you know, we do believe that when you are a company that has 26 million subscribers in the U.S., 100 million wireless customers who desire that content, that you are very attractive to the programmers and the content developers, and so we do feel fairly confident that we can get those programming costs to look like the DIRECTV programming costs. That is the mechanical piece that we believe can happen in a fairly short period of time. We are not making any assumptions that DIRECTV, their programming costs can go down.

It is just that we can make the AT&T costs look more like the DIRECTV costs.

Senator BLUMENTHAL. And you think that is true, Mr. White?

Mr. WHITE. Yes, but I think you are raising a very good point. All of us—and I have been fighting content cost increases because I hear from my customers all the time about their frustration with the increase in their pay-TV bill. We fought, I think, the good fight at DIRECTV. We have had a number of blackouts with big companies as well as medium-sized media companies. There is no easy answer to rising content costs, frankly, but in this particular case, I think the savings that Randall is referring to are specifically in comparing their content costs to ours and trying to figure out how we get their rates through negotiation to our rates and where we already are. And that is what we are talking about in terms of content costs. Beyond that I would say it is pretty hard, as I said, to commit to lower prices on a pure play video product because of the power of the content companies.

Senator BLUMENTHAL. Well, let me take the next leap of faith. Assuming just for purposes of this argument that you are successful in driving down the costs of content and achieving cost savings more generally, can you commit that those cost savings will be passed along dollar for dollar to consumers? Mr. Stephenson.

Mr. STEPHENSON. Dollar for dollar, no, sir, I cannot commit to that. What I can commit is it is a highly competitive industry, and margins get competed away in these industries. That is why what we are submitting as support the econometric models that the DOJ will use when they review this, and those models strongly indicate downward pricing pressure.

Again, the prices will go down? I do not think we want to intimate that. But what we do believe is the trends can be changed—the programming costs going up 8 percent a year—and that will mitigate the price increases that we are having to pass along to consumers.

Senator BLUMENTHAL. So the best you can tell us is that price increases will be mitigated?

Mr. STEPHENSON. Slowed, yes.

Senator BLUMENTHAL. In other words, the rate of increase will be slowed.

Mr. STEPHENSON. We hope that would be the byproduct of this.

Senator BLUMENTHAL. That is the best you can promise us will result from this merger?

Mr. STEPHENSON. Yes, sir.

Senator BLUMENTHAL. Is that true, Mr. White?

Mr. WHITE. I think you will see better value bundles. On the pure play pay-television business, it is very difficult because of the cost of content, which is far and away our biggest cost. But we have not had a competitive broadband video bundle, and I do think you will see better value for consumers than we currently—

Senator BLUMENTHAL. And what is your projection, Mr. Stephenson, as to how much mitigation, how much reduction in the rate of increase there will be? What percentage?

Mr. STEPHENSON. Well, as I mentioned, it is a bit episodic, meaning it is event specific, getting the AT&T costs to look like the

DIRECTV costs. And so we believe that we can drop our content costs by as much as 15 percent and maybe a little more.

Senator BLUMENTHAL. And what percentage of that will be passed along to consumers?

Mr. STEPHENSON. It is hard to say. I mean, I cannot even tell what the prices of these services will be 6 months from now. This is a hyper-competitive market. It moves literally by the week. And so prices are changing in this market constantly. You are trying to meet the competition. You are doing promotional pricing on a regular basis. So it is hard to even say what it will be 2 months from now, much less 3 years from now.

Senator BLUMENTHAL. Well, I feel like I am watching the movie—I do not even remember what it was, but it just occurred to me, you know, there is a line, “It is complicated.” And I have this sense that we are watching a rerun here of—you know, with all good intentions, you are telling us that you cannot really give us the specifics, but we are not going to see any drop in prices. At the best we will see some reduction in the rate of increase. And I think a lot of consumers would find that answer unsatisfying.

Mr. STEPHENSON. Yes, sir, I suppose one would have to believe in the market and the market pressures and that market pressures will compete margins away and cost savings will find their way into prices, because the cost savings in this deal are very specific, and they are fairly hard. And so if you believe the industry is competitive, the margins do get competed down.

Senator BLUMENTHAL. Well, that is why I asked you—and my time has expired. I apologize. But that is why I asked you whether you could commit that those cost savings will be passed along, if not dollar for dollar at least maybe 50 percent, 75 percent. Can you give us that answer?

Mr. STEPHENSON. Not here right now. I mean, we can get back to you, but I cannot tell you exactly what those numbers will be.

Senator BLUMENTHAL. Thank you.

Thank you, Madam Chairman.

Chairman KLOBUCHAR. Thank you.

Senator Cornyn.

Senator CORNYN. Thank you, Madam Chairman. Thank you all for being here today, and Mr. Stephenson, of course, heads up a Texas-based company, a small Texas-based mom-and-pop.

I find these kinds of hearings a little surreal in some ways because, of course, we do not have jurisdiction over whether this merger occurs or not. That is the Department of Justice and the FCC. But I do think it is helpful to learn and think more deeply about these issues. But I also remember that there is a famous quote from Yogi Berra, who said, “It is tough to make predictions, especially about the future.” And, of course, we are having to make predictions about the future here, and I wonder about the institutional competence of Congress to do that. But I am certainly interested in what you have to say.

I know there has been concern expressed in some testimony already about how this merger affects rural consumers, but as you know, Mr. Stephenson, we have large, expansive rural areas in Texas. Would you reiterate or perhaps tell us what advantages you think this merger would offer to those rural consumers?

Mr. STEPHENSON. You bet. One of the elegant pieces of this deal is Mike has a video distribution capability that is very efficient for rural delivery of television. Getting broadband to rural America, this Committee knows as well as anybody, it is really difficult to get an economic basis for putting broadband into rural America. The wireless technology that we have developed, when you combine it with a profitable video product, gives us an opportunity to get this wireless technology deployed. It is good technology. This is high performance technology, 15 to 20 megabits per second capability. And just as an example, for our State of Texas, Senator, we will pass almost 500,000 additional homes in the rural areas of Texas with this technology. In Minnesota, it is 484,000. In Connecticut it is 94,000. These are hard commitments. These are commitments we are willing to make and do intend to make. We will build this out and pair it with a TV product. We think this is an exciting opportunity for rural America.

Senator CORNYN. I think it was Mr. Wood—and he can correct me if I am wrong—who said that there was no good reason for this merger, that you ought to spend the \$70 billion building out your broadband network independently. What is your response to that?

Mr. STEPHENSON. I do not see the capital markets stepping up volunteering to fund that kind of broadband build across America. That is a mega capital commitment. If I were to come out and announce a commitment to build that kind of fiber deployment across America, you could have my successor testifying in front of this Committee. The capital markets are not there to finance it. We are always looking for more efficient ways to deploy the technology, wireless, again, referred to as “inferior.” It is actually superior. It has better cost dynamics and allows us to get greater coverage of broadband than fixed into rural America.

Senator CORNYN. Well, since I invoked his name, in fairness, I will ask, Mr. Wood, would you care to respond to that answer?

Mr. WOOD. Sure. I think first of all, for the rural benefits on the buildout, what is hard to follow is exactly what is new here, because AT&T committed in 2006 with the Bell South merger to provide broadband throughout its entire wireline territory, some of that being wireless. This is, I think, a commitment to expand that outside of the AT&T wireline footprint. But, again, they also said last month that they were providing a wireless home phone and Internet product throughout the entire country at this point.

So the benefits for rural, regardless of how good the technology is or how much better or worse it is than other options, I think are hard to follow, once again, just because we have heard these kinds of promises before, and it is not entirely clear, to me at least, what is new and what is specific to this merger.

When it comes to the fiber build in the capital markets, I think that points to one of the problems we have here. Mr. Stephenson describes that as a—was it a mega intensive capital project? But, of course, when they expend that same amount of money on a merger, their stock price goes up. And so what we have is Wall Street and investors, who are perfectly free to have that opinion, favoring mergers and actually dissuading companies from investing in new builds without taking out competition. Somehow AT&T can find the money and the purpose and the reason to invest in fiber

where Google Fiber goes first—now, Google Fiber is not everywhere, but it has shown up in a few places, and AT&T can invest there. We wonder why that is not the case other places, and perhaps that is because it is not all that competitive in other regions. If we had competition, we might get investment.

Senator CORNYN. Well, Mr. Wood, what I understand Mr. Stephenson to say is he thinks this is probably an investment better calculated to return something on their investment for their shareholders, and you see nothing wrong with that, do you?

Mr. WOOD. No, although I would note that when Google did their fiber build in Kansas City, the early reports were something like 75 percent take-up rate. So even with an average take-up rate of something like 30 percent in the industry, we think that this amount of money could be used to go past 71 million homes and to sign up 20 million or more new customers. I would think that would be a profitable endeavor, but, of course, I do not have access to AT&T's numbers for this deal yet. We will be looking at those numbers as well during the FCC process.

Senator CORNYN. Well, I wonder if some of you may comment on this question. I noticed that in the written testimony one of you mentioned the high cost of ESPN to pay-TV providers. Another mentioned concerns about accessing regional sports networks. And this entire merger is, as I understand it, contingent on the ability of DIRECTV to renew its NFL Sunday Ticket contract.

Why are these sporting events so valuable to pay-TV providers? And how is the demand for athletic content influencing the cost and structure of pay-TV? Mr. White, that sounds like a good question for you.

Mr. WHITE. Sure, Senator. Clearly, in today's world sports is the one live event that you get people to watch and, therefore, advertisers are interested in advertising against. And so increasingly, in a more fragmented world, we are seeing more and more it is sports that draws people together, and that is where you see, as you pointed out, a significant pressure on content costs is coming from sports. But it is still the one thing folks gather around in the bar, the television in the family room, or elsewhere to watch, is sports.

Senator CORNYN. Well, I am old enough to remember some of the apocalyptic predictions that have been made over time about what the future holds. I remember reading a book called "The Population Bomb," by B.F. Skinner, that said we were all going to starve because the population would outpace the capability to grow the crops and to produce the food to feed us. And that thankfully did not prove to be true.

So I think that is the hard part about trying to evaluate these kinds of deals that we are being asked to predict the future, and you no doubt—I hope and trust you are in a much better position to predict on behalf of your shareholders and consumers what the future looks like in this very fast-moving and complex area.

Thank you, Madam Chairman.

Chairman KLOBUCHAR. Thank you very much.

Senator Franken.

Senator FRANKEN. Thank you, Madam Chairwoman, and thank you to all the panel here today. This is the second time in 3 months that the Members of this Committee have met to discuss a deal

that could transform the telecommunications industry. Consumers are more dependent on this industry than ever before. We need more investment in telecommunications, investment in infrastructure, in customer service, and in new technologies. Instead, the industry proposes more consolidation. Comcast wants to buy Time Warner Cable, Sprint wants to buy T-Mobile, and AT&T says that because of this they need to get bigger, too.

To me that is not a good reason to approve a deal. We need to examine this merger on its own terms. AT&T and DIRECTV have explained why this is a good deal for them. As good corporate citizens, they must also explain why this is a good deal for consumers.

I just wanted to pick up on something that Senator Cornyn said, not predicting the future. I remember when fin-syn was rescinded in 1989, and there was testimony, Mr. Keyser, then from the networks that this would not reduce independent producing. But I remember people in the Writers Guild saying it would. Who was right?

Mr. KEYSER. I am afraid that we were right, Senator.

Senator FRANKEN. So you were able to predict something right, accurately, because it flowed from what fin-syn was—the networks owned—were not allowed to own their programs, and they wanted to be able to own them. And they said, “Hey, we are not going to favor our own programming. We want to get the highest ratings possible. Why would we favor our own program?”

What was the percentage of independent programmers then and what is the percentage now?

Mr. KEYSER. Senator, I think it was somewhere between 70 and 80 percent before fin-syn and we are down to about 10 percent now, but much of that is reality programming. It is not scripted programming.

Senator FRANKEN. Right, so the prediction actually was true, so we can see the future a little bit.

I would like to talk about how this merger would affect consumer prices. Mr. Stephenson and Mr. White say they need this deal to sell a better bundle. That is a package of TV and Internet and phone services all rolled into one. But bundles are only good for consumers if they actually offer cost savings, not if they are structured to hide the true costs of each service or force people to buy products that they do not want. This merger would increase AT&T's bundling power, but I am not sure that is what consumers want. Many of my constituents complain to me about bundles. They feel that they are getting a raw deal.

Mr. Wood, you are a consumer advocate. Should consumers be concerned about AT&T having more bundling power?

Mr. WOOD. Yes, I think so, Senator Franken. We have heard this afternoon that margins get competed away in these business because they are so competitive. I think what we see instead is sometimes margins are taken away programming costs rise more quickly than consumers are willing to pay those increases. But the margins get shifted, and so even if a company's video margins are declining, even the biggest, even Comcast, these declining video margins—still high profitable, mind you, but declining over where they once were, their overall company margins are better because they are able to shift that revenue and shift those profits into broadband

in ways that I think are attractive to the companies but necessarily good for their customers.

Senator FRANKEN. Mr. Stephenson, you have promised to offer your customers a stand-alone Internet plan if this deal is approved. Stand-alone plans are very important for consumers, especially so-called cord cutters who do not want to pay for expensive bundles. They just want the Internet. Many of my constituents want this option, and my view is that you should be offering it whether the deal is approved or not.

However, this is not the first time that AT&T has made this promise. Back in 2006, when your company was acquiring Bell South, you promised to offer your customers a stand-alone Internet plan. But after that deal went through, you did not advertise it. Instead, you hid the plan deep down in the terms and conditions page of your website. Most of your customers did not know that it existed. This sounds to me like a broken promise, an example of consumers being forced into expensive bundles that they do not necessarily want.

Mr. Stephenson, would you commit here today to selling a stand-alone Internet plan that is clear and visible to consumers?

Mr. STEPHENSON. Yes, sir, I will. I will commit it directly to you. We have 11 million high-speed broadband customers today. Of those, only half have our TV product. We very much aspire to have a stand-alone broadband product. We are a broadband company. That is our primary product that we sell in the consumer home solutions space today. So, absolutely, I will make you without equivocation that commitment.

Senator FRANKEN. Thank you.

Let us talk about rural broadband. I have worked to get rural broadband expanded. You know, I do not know why this deal, which costs \$67 billion, could not be invested in rural broadband, Mr. Wood. And I have to say that many towns in Minnesota—you mentioned Minnesota, Mr. Stephenson—are fed up with being disconnected from the digital economy, and they have taken matters into their own hands. They want to build their own locally operated broadband networks. There is a lot of evidence that these municipal networks provide excellent and affordable service and they are good for the economy. Mayors, city councils, and county boards across America want to invest in municipal broadband, but in many States their hands are tied. In some places, municipal broadband has been outlawed on the grounds that it might compete with private companies. This is blatantly anti-consumer, and I think it violates local government rights.

Mr. Stephenson, AT&T reportedly spends a lot of money lobbying for these anticompetitive laws, and that has worried me about what you will do if you become a bigger player in rural areas. Municipal broadband is a way for small towns to take control of their economic destiny. If they want to build it, the law should let them build it.

Mr. Stephenson, if cities want to build their own networks, why should the law stop them?

Mr. STEPHENSON. Areas that are unserved with broadband, I actually have no issue with what you said. Those where there are private capital alternatives and private capital is stepping in to build

it, quite frankly, the idea of private capital competing with taxpayer-provided capital just feels inconsistent to us with what a free market system looks like. But where it is unserved, it seems like a logical place for Government to step in and provide a solution.

Senator FRANKEN. But, in other words, you do not deny spending capital, spending money on this legislation to prevent municipal broadband?

Mr. STEPHENSON. I do not know if we have spent money or not. I have personally advocated that where we are investing or others are investing private capital, that we should not be required to compete against Government taxpayer money. But where it is unserved, then—

Senator FRANKEN. Well, I know I have run out of time, and so your answer is that you are not aware that AT&T has spent money lobbying and has given money to groups that lobby to prevent municipalities from setting up their own broadband?

Mr. STEPHENSON. I do not know where we have given lobbying—I am not saying we have not. I just do not know.

Senator FRANKEN. You do not know.

Mr. STEPHENSON. I do not know.

Senator FRANKEN. Okay. Thank you.

Thank you, Madam Chair.

Chairman KLOBUCHAR. Thank you, Senator Franken.

Just coming off the rural issue, a different piece of it, Mr. White, DIRECTV's early focus—you and I have talked about this—was rural America where satellite is often the only way to go to get video service. You currently have more than 7.5 million subscribers, 36 percent of your customers in rural areas. Serving rural America is important to me, as you know, and to Senator Franken and many on this Committee.

Are you still committed to rural America? Will you commit to carrying rural-focused programming after the merger with AT&T? And I specifically note that AT&T is the only national carrier that is not carrying RFD-TV, which is an independent channel focused on rural America. And I am wondering what is going to happen with that, but I will start with you, Mr. White.

Mr. WHITE. Sure. I think I will have an opportunity to convince Randall that RFD-TV would be great for them to carry.

Chairman KLOBUCHAR. That sound very good.

Mr. WHITE. As we do at DIRECTV. But rural America is very important to us. The satellite has unique advantages in rural areas where we are not competing with fiber to the home. And I think it continues to be important to us. Frankly, having 20 million subscribers is very important for our competitiveness when we negotiate content deals. And so we want to have as many customers that we can serve well as possible. We pay a lot of attention to what our rural subscribers are interested in in the way of content. We have over 150 independent networks that we carry on DIRECTV. We think the diversity of that content is important to our customers, and we intend to continue to actively support those rural areas.

And I would say with regard to the discussion about pricing, it is always hard for any business person to answer, but you could not afford the capital to build out 15 million homes broadband if

it were not for this deal. And that is a significant investment. So without a profitable video business coupled with AT&T's capability to build that broadband, we would not have it.

So that is where the real investment is. It makes that investment a smart investment for our shareholders.

Chairman KLOBUCHAR. Okay. Mr. Keyser, given recent media consolidation, not just this deal, the number of independent channels, as you well know, we just talked about it, has been shrinking. And we have heard from many of the remaining independent programmers that they are confronted with challenges of getting their content to consumers. They claim that they lack any real leverage in negotiations compared to channels owned by major conglomerates with multiple cable networks and/or broadcast networks. As a result, they often are forced to accept smaller fees compared to channels that do not rate as well, poor channel replacement, and more restrictive distribution conditions that the non-independently owned channels get.

You have member writers who partner with independent programmers. Do you want to talk about this concern and what you have seen?

Mr. KEYSER. Thank you, Senator. Yes, we are very concerned about that. I have had conversations with a number of independent programmers who talk about the disadvantage they are at in dealing already with DIRECTV even before it acquires this additional competitive advantage, for example, policies such as demanding most-favored-nation deals with those independent programmers, which means that DIRECTV will pay only the worst deal that those programmers get from any other distributor.

In addition, they often put onerous restrictions on the distribution of their content through the Internet, and those are restrictions that are not placed on larger providers. All of those pressures eventually will lead to less programming opportunities for us, for writers, and for viewers who see that content, and eventually probably will, in addition to that, lead to mergers of content providers, which is the second thing that we are worried about, in order to effectively compete against distributors who have an enormous leverage in that one-on-one negotiation over the cost of content and the availability of that content, they will eventually need to—they will need to merge.

At some point, Senator, if you have a chance, I would love to speak about the question of content cost. I do not want to interrupt now.

Chairman KLOBUCHAR. I was getting at that. You can answer. You have been kind of quiet here, you know, while making candlabra jokes.

Mr. KEYSER. You know, I am an independent producer——

Chairman KLOBUCHAR. I think you can have an opportunity to talk about——

Mr. KEYSER [continuing]. Of answers in this panel.

Chairman KLOBUCHAR [continuing]. Content costs. I was asking about that in part in my question.

Mr. KEYSER. There is a lot of conversation about content cost. We have heard that it is 60 percent of the cost of doing business, that costs are rising. Those are descriptive and not normative conversa-

tions about what content costs are. Quite apart from the question of whether a virtual monopoly is likely to pass on its own efficiencies to its consumers, we ought to point out that there is another transaction that is going on here, which is the transaction between those who purchase the product that content providers make and those who distribute it, essentially provide the shelves.

They have every right to lower their costs as much as they can through a fair market transaction. What they do not have the right to do is to put the kind of pressure on that transaction that occurs when they essentially own all of the shelves. What that means is that if I need to sell my product, if I am the person who makes a television program that a writer writes and the audience wants to see and I have only one place to put it, I have no ability to actually exact from the transaction the fair cost of what I produce. And if that is permitted to happen, what is going to end up happening is the amount of product will be reduced, and that is bad for me as a writer and all of my writers, but really in the long run, the people who it is most—who it puts most at a disadvantage is the consumer.

Chairman KLOBUCHAR. You know, as we talk about this consolidation and some of the issues you raised, you do start to think, and we know we have had a lot of innovation in the last few years, and from some major companies, but at what point is it enough? You know, with the rumors of Sprint-T-Mobile, with what we had with Comcast, what is that tipping point when it is appropriate for anti-trust laws to step in? I do not know if anyone wants to take—Mr. Downes, you believe in fair—in competition, but is there some point where everyone is merging, where you have too much of this and too much consolidation?

Mr. DOWNES. Well, of course, it is possible. I do not see this as a particular risk now because, as I say, we keep getting these increasing declines in the component costs of the basic technology, and that is what is driving the real innovation. That is what is really driving competition. I think these mergers, this one in particular, is, as I said, a defensive one. It is in response to rising pressure—good pressure but rising pressure from over-the-top services, which is where the real innovation is happening. It is unregulated, and that is where we are seeing, you know, people figuring out new ways of delivering content, new ways of producing content, new ways of attracting audience, new ways of monetizing—

Chairman KLOBUCHAR. Right, but how about the fact that the prices keep going up for consumers?

Mr. DOWNES. Well, the prices of the programming bills are going up because the large content providers are forcing larger and larger bundles of channels onto the distributors. As I say, the FCC says the actual average cost per channel keeps going down, but if the bundle gets bigger, then you do not see that in terms of any reduction.

Chairman KLOBUCHAR. Mr. Wood and then Mr. Lieberman.

Mr. WOOD. Interesting on that last point that we see bundles actually leading to increased prices when they are forced on people, but turning to your device cost point, Mr. Downes, and your question, Senator, that is what happens when we have a truly competitive market, is we actually see prices dropping, not going up. So

I think that is a fair comparison, but we do not just expect to see prices only rising slightly or rising less quickly than they would have otherwise. If there is a truly competitive market and people are empowered to make choices and actually have choices available to them, we should see prices going down for technology, not simply treading water or continuing to spiral out of control year after year.

Mr. LIEBERMAN. For pay-TV providers, content costs are a problem. They are rising very quickly.

The second problem deals with the discriminatory pricing practices. Smaller operators pay 30 percent more for programming than larger operators, and these operators that are buying this program are often serving in rural areas. So when we hear about this deal providing benefits to rural America because AT&T is going to be able to lower their programming costs to provide service in these areas, I am left here thinking to myself that if there are concerns with the deal and there are concerns about not having broadband in rural America and service in rural America, that there are smaller operators that are already there having difficulties—and telephone companies as well having difficulties with programming prices. If you can address that issue, either through an examination, a report on what is going on, to better understand what that problem is, you could then empower those operators that are already in these markets to be more competitive in the market and then to use the savings that they have to further deploy broadband in their areas. It is a different approach to solving the problem than just allowing mergers to happen.

Chairman KLOBUCHAR. Okay. One last question before I turn it over to Senator Lee I guess I will ask you, Mr. Wood, or anyone else. We have heard concerns a little bit about what Mr. Keyser was talking about, about MVPDs, including DIRECTV, that demand very restrictive most-favored-nation or, as it is known, MFN provisions that ensure that the MVPD gets the best contract provisions independents provide to any other MVPD, regardless of whether provision is negotiated as part of a broader package. These most-favored-nation clauses can benefit consumers in terms of ensuring better pricing, but are there instances where MFNs can be anticompetitive and harm consumers? And are they typically regarding pricing, or are they increasingly about restricting content from being distributed by online video providers?

Mr. WOOD. I am happy to answer, Senator, but I am sure others have views on this as well. I think that MFNs could cause harm to customers, and that harm really stems from not knowing what people are paying for each individual programming choice. This is often referred to as “a la carte” in cable parlance. And so whatever the MFN does to the price, ultimately, or to increase the value of the service or to offer people more or less choice, if consumers had more of a view into what they are paying, not only for each programming stream and each programming channel, but also for their broadband as compared to their video programming, I think that kind of transparency in pricing would help to, if not get rid of MFNs, then alleviate some of the problems from them where people would have a choice and some insight into what they are actually buying and how much it costs.

Chairman KLOBUCHAR. Okay. Mr. Keyser, do you want to add anything? Then we will end with Mr. White, and then turn it over to Mr. Lee.

Mr. KEYSER. To me, the real question here, apart from what Mr. Wood says, is that it is a two-part transaction, and the important thing is that we have no guarantee that the consumers get the benefit of increased efficiency on the part of the combined companies. What we do know is that the negotiation posture that they are able to take with those who provide them the content, either independent producers or independent channels, becomes unequal. In the long run that is fundamentally unfair, and particularly unfair when there is no indication that consumers are going to benefit from it.

Chairman KLOBUCHAR. Okay. Thank you.

Mr. WHITE. So, Senator, having been involved in these negotiations for the last 5 years, including MFN or most-favored-nation discussions, I can tell you exactly how it is used. I think of it as a seat belt. There is no transparency whatsoever into what the content companies are charging my competitors. Therefore, I am left there to fight on behalf of my customers to say, Are we getting a fair deal? I am going to fight hard for my customers to make sure that they are getting a fair deal and that there are not other games being played. And so the MFN is strictly a way to protect ourselves as a defensive thing to make sure that when they come in and tell me they want a 30-percent increase or a 50-percent increase—by the way, our retransmission fees have been growing 55 percent over the last 3 years—that I can at least have some discipline, some check and balance to make sure that our customers are not paying more than anybody else, particularly our rural customers.

Chairman KLOBUCHAR. Okay. Last, Mr. Lieberman.

Mr. LIEBERMAN. Thank you. I would say it from the other side as the smaller operators who often do not get MFN deals, provisions in their contracts. When they negotiate with programmers and they sometimes try to ask for different types of deals, creative deals, deals that might address their particular circumstances, programmers often tell them, “I cannot do that,” and the implication is it is because it will implicate MFN provisions that are in larger providers’ deals.

So sometimes the ways they may be used as Mr. White has described; in other cases, it is used to actually limit the way that competitors or smaller providers are able to negotiate their deals.

Chairman KLOBUCHAR. Okay. Senator Lee.

Senator LEE. Thank you, Madam Chair.

Mr. White, I want to start by getting your response to Mr. Keyser’s point about the effect of the merger on your ability to obtain content at below-market rates. Tell me what your best response to that is.

Mr. WHITE. That is not really part of our assumptions, nor have we said that I am going to get anything—I do not think I get anything below market rates, although I try, with the content providers. So I think what we have been saying is that in the U-verse geographies, the 5 million U-verse subscribers are paying quite a bit more for the content than DIRECTV customers do, and that we would get those savings.

As it relates to the rest of our business, you know, we actually think there are opportunities for the programmers with the wireless opportunities that AT&T has to find new ways to monetize their content on other platforms.

Senator LEE. Okay. And so your assessment is that the net impact of that would not leave the content providers without a place to sell their product.

Mr. WHITE. No, absolutely not. And we expect to have even more channels carried over the top. So, for instance, today we have Pandora and YouTube, but it requires Internet. And for us to expand that to other opportunities of channels that want to go over the top as an app, we need more Internet.

Senator LEE. Okay. Mr. Lieberman, you raised some concerns about DIRECTV's vertical integration and specifically about the prices that it could charge to its rivals for content that it owns, that DIRECTV owns.

Mr. LIEBERMAN. Yes.

Senator LEE. You also expressed some doubt as to whether arbitration could take care of that, some of kind of arbitration requirements could take care of that. Which content in particular do you think DIRECTV could either withhold from its rival—that it could withhold from its rivals? And why don't you think arbitration agreements might work in that context?

Mr. LIEBERMAN. Sure. Thanks for the question. So, generally, regional sports networks are the most in demand the highest-priced programming, and vertically integrated operators that own that programming have the highest incentive to charge their rivals high prices for that. So, in particular, like Root Sports Rocky Mountain, which covers Colorado as well as Utah, I have nine members in Utah that carry this programming. They also compete with DIRECTV, and they have to negotiate with them for this programming. DIRECTV has an incentive to charge them higher prices than they would charge to anybody that they would not compete against.

This issue has been raised in other merger considerations at the FCC, and the FCC has found this to be true with economic theory as well as evidence. And what they have adopted is they have said that existing program access rules are not enough, that we need to—and their solution to it was baseball-style arbitration, where, if there is a negotiation impasse, both sides put in their best offer, and an arbitration decides what is closest to fair market value.

It is an elegant solution that works well for larger operators. The cost is estimated to be \$500,000 to \$1 million. So if you have that kind of money and the program is—and the cost differential is going to be that great, you go for it. But the operators that—these nine operators I mentioned, like an operator in Spanish Fork City has 5,000 subscribers, you are not going to spend between \$500,000 and \$1 million to pursue this remedy in order to save yourself, you know, a smaller amount.

So there needs to be a remedy that is adopted to address this problem, and there needs to be some new thinking on it in order that all providers can benefit from it.

Senator LEE. Mr. Downes, as you note in your testimony, the importance of broadband appears to be on the increase, you know, as

consumers are increasingly relying on that medium, and not just for data but also for voice and even for video. Do you see this trend continuing into the future? And how do you see this particular transaction impacting that trend in the market for high-speed Internet?

Mr. DOWNES. Thank you, Senator. So essentially we now have, you know, almost complete convergence of a lot of different technologies for distributing voice, data, video, have now all pretty much converged on the Internet as the one set of protocols that they are going to use and it does not really matter anymore so much what tech—some technologies are better for some things than others. But, yes, broadband Internet is going to be the core of how not just content but how all interactions happen, including, you know, the Internet of things and home security and all the future services that are going to be built on top of that network.

I think as far as this transaction is concerned, the one thing that is very important to note is, with all due respect to Mr. White, satellite is not a particularly good technology so far; at least the physics of it do not seem to really work very well as a way of communicating broadband speeds. And so if DIRECTV is going to remain a viable competitor in this market, it really needs not just better integrated broadband, but really natively broadband technology, because, you know, it is not just that I want to watch TV now and then I want to do some Internet later. It is I am going to start watching a program on one device, and I want it to pick up on the other device exactly where I left it off. And that is not just about the kind of business integration that the parties are talking about. That is really a technical integration that is going to be essential to deliver, I think, what are going to be next generation broadband services.

Senator LEE. Mr. White, my sense of due process is such that I feel the need to give you the chance to respond to Mr. Lieberman's statement a few minutes ago.

Mr. WHITE. Yes, so two quick points. One, I think that is exactly why we are excited about this opportunity, is we get broadband and we get it in many more places because we will have a profitable video business married to a broadband business, and it underpins the investments that AT&T is promising.

The second thing I just wanted to say on the regional sports networks, I would be the first to tell you that the regional sports network business is a difficult business. We have had our own challenges at DIRECTV in Los Angeles. But I would also point out that the three RSNs that we have, in Pittsburgh, in Colorado, and in Seattle, AT&T does not overlap in any of those geographies and is not a factor. So it has nothing to do with the merger.

Senator LEE. So this merger would not impact any of those three RSNs?

Mr. WHITE. Not at all, no.

Senator LEE. Okay. All right. Thank you. I see my time has expired. Thank you.

Chairman KLOBUCHAR. Okay. Well, I think we are done here, and this has been a very good hearing with a lot of good questions. I think that while we see that there are—the services are complementary in many ways and there are some benefits that have

been laid out, we also see that there is some estimates that 41 percent of the market share the two companies have in Los Angeles, 42 percent in Dallas, 43 percent in Atlanta, and so we have some issues there. And then also I think that the witnesses have done a good job of laying out some of the content concerns and the leverage issues, which I am sure we will be exploring more with questions and information to the Justice Department and the other agencies.

But I do want to thank the witnesses once again. You have done a very good job. I do want to ask unanimous consent that we include the following items in the record: a letter from the Communications Workers of America supporting the merger; a letter signed by the National Association for the Advancement of Colored People, the NAACP; and the National Association of Black-Owned Broadcasters that also notes some issues that I think are very important.

Then we also have—okay, we have multiple copies of the letter in case everyone wants one.

[The letters appear as submissions for the record.]

Chairman KLOBUCHAR. We will keep the record of the hearing open for 1 week, and I want to thank our great staff that have been working on this hearing: Caroline Holland, right behind me, whom many people know; and Kate Geldaker; as well as all of the staff for Senator Lee and Senator Leahy and everyone who has been involved in this hearing. These are complicated matters. They are very important to consumers, and we look forward to working on this in the months to come.

Thank you very much to all of you. The hearing is adjourned.

[Whereupon, at 4:26 p.m., the Subcommittee was adjourned.]

[Additional material submitted for the record follows.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Witness List

Hearing before the
Senate Committee on the Judiciary
Subcommittee on Antitrust, Competition Policy and Consumer Rights

On

“The AT&T/DIRECTV Merger: The Impact on Competition and Consumers in the Video
Market and Beyond”

Tuesday, June 24, 2014
Dirksen Senate Office Building, Room 226
2:30 p.m.

Randall L. Stephenson
President and Chief Executive Officer
AT&T
Dallas, TX

Michael D. White
Chairman & Chief Executive Officer
DIRECTV
El Segundo, CA

Christopher Keyser
President
Writers Guild of America West
Los Angeles, CA

Matthew F. Wood
Policy Director
Free Press
Washington, DC

Larry Downes
Project Director
Georgetown University, Center for Business and Public Policy
Washington, DC

Ross J. Lieberman
Senior Vice President of Government Affairs
American Cable Association
Washington, DC

PREPARED STATEMENT OF RANDALL STEPHENSON

STATEMENT OF RANDALL STEPHENSON

CHAIRMAN, CEO, AND PRESIDENT

AT&T INC.

HEARING:

THE AT&T/DIRECTV MERGER: THE IMPACT ON COMPETITION AND
CONSUMERS IN THE VIDEO MARKET AND BEYOND

UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND
CONSUMER RIGHTS

JUNE 24, 2014

STATEMENT OF RANDALL STEPHENSON

Chairman, CEO, and President

AT&T Inc.

Hearing

The AT&T/DIRECTV Merger:

The Impact on Competition and Consumers in the Video Market and Beyond

**United States Senate, Committee on the Judiciary, Subcommittee on Antitrust,
Competition Policy and Consumer Rights**

June 24, 2014

Thank you, Chairman Klobuchar, Ranking Member Lee, Members of the Committee.

I am Randall Stephenson, Chairman, CEO, and President of AT&T, and I appreciate this opportunity to discuss the significant consumer benefits of AT&T's acquisition of DIRECTV.

This transaction is about meeting consumer demand. It's about providing consumers with the integrated video and broadband Internet services they want, delivered over any type of device, to nearly anywhere in the country. It's about fueling investments that bring new and faster broadband connections to millions more Americans, the vast majority of whom reside in underserved rural areas. It's about bringing new competition, new services, and new levels of customer satisfaction in ways that neither company could do on its own.

DIRECTV has the premier pay-TV service in the United States. AT&T has powerful broadband networks throughout the country. By integrating DIRECTV's video capabilities with our strength in fixed and mobile broadband delivery, we will create a new competitor with unprecedented capabilities. And, the substantial cost savings and other synergies associated with the transaction will allow us to price all of our services more competitively, which will drive cable and other competitors to lower their prices and improve their own offerings.

In addition, the transaction fundamentally improves the business case for expanding AT&T's broadband infrastructure to millions more Americans. Indeed, being able to offer DIRECTV's video product on a nationwide basis gives us the confidence to expand and enhance our high-speed broadband service to at least 15 million customer locations across 48 states, mostly in underserved rural areas, within four years after deal close. This represents a multi-billion dollar commitment of capital that AT&T simply could not make without the ability to pair DIRECTV's video products and scale with our newly-expanded broadband services.

Finally, the transaction will position AT&T to meet consumers' evolving video preferences and, in particular, to propel the development of new "over the top" video services offered by AT&T, Netflix, Hulu, Amazon and others. And, we will do all that while meeting or exceeding the FCC's net neutrality standards and extending our best-in-class diversity and labor practices to the employees and suppliers of the combined company.

I will now address each of these topics in more detail.

Combining Complementary Strengths to Meet Consumer Demand

One basic consumer preference is shaping the communications marketplace: demand for integrated video/broadband services and the new generation of emerging offerings they deliver. This transaction enables the combined companies to meet that demand and allow consumers to choose when, where and how they experience video far better than either can separately.

AT&T has world-leading networks. Our 4G LTE mobility network can deliver video quickly to nearly 300 million Americans across a broad range of devices. Upon completion of the expansion of our high-speed wireline broadband networks, we will serve 70 million customer locations and deliver instantaneous access to all the Internet has to offer. But video entertainment services are essential to success in the marketplace, and ours cannot meet the needs of enough consumers. Due to technology and economic limitations, we can offer video in only a small portion of the country – less than a quarter of American households and even in our

wireline service territory, only in more densely populated areas. The cable companies, on the other hand, have a complete overlap of their broadband and video offerings.

Where we offer video, we lack the scale needed to forge strong relationships with programmers and compete effectively against the dominant cable companies. A case in point is our cost to acquire video content. Today, 60 cents of every video dollar we earn goes straight to programmers, before we spend a penny to market our service, install a set top box, send a bill, or answer a customer's call. As a result, our video product is, on its own, unprofitable. More than 97% percent of our video customers purchase video along with another AT&T product.

DIRECTV is the premier TV brand in America, and its video service is profitable. But it does not have a broadband product and cannot meet the growing demand for integrated offerings that include broadband Internet access. Nor can it offer a full range of interactive capabilities or mobility-enabled viewing. The combined company can do all those things.

The merged company will be perfectly poised to give consumers what they want. This transaction solves our challenges in video and realizes the full potential of our networks. We will combine Internet and home services with video and video interfaces. Our mobile network can become a national video distribution system. Video can be delivered everywhere to mobile phones, computers, tablets, cars, even planes. We will offer value to programmers that will lead to better traditional video services and bundles and to new over-the-top video services.

Better and More Advanced Services for Consumers

By combining complementary services and generating deep cost savings and operational synergies, the merger allows AT&T to price more competitively and to provide a higher quality experience. Customers will get a single bill and a single installation. They will have a single point of contact for placing orders, answering questions, and solving problems. Our 2,000 company-owned stores and 10,000 retail locations will show customers how home and communications products can meet their needs and ensure that we deliver what we promise.

With a combined AT&T and DIRECTV, the home experience will be better – much better. With leadership from AT&T Labs and DIRECTV's video engineering team, we will be able to innovate in set-top boxes, customer interfaces, and DVRs that will be seamlessly integrated across all of our networks and devices. Informed by the home automation expertise we have developed through our Digital Life service, we are just beginning to explore what the use of voice commands, flexible interfaces, and integrated services can mean for controlling home systems as well as video entertainment and for making sure that all citizens, whether vision or hearing impaired or having trouble moving about, can take advantage of all these services.

Bringing Better Broadband Infrastructure to Rural and Other Customers

The addition of a profitable video product to AT&T's portfolio is a game-changer in the economics of deploying broadband. This transaction will allow us to lower content costs for AT&T video subscribers by 20% or more, and we project total cost synergies to exceed \$1.6 billion annually within three years after closing. These transformative effects will dramatically improve the economic case to invest in new broadband infrastructure to millions of customer locations.

With this merger, AT&T will build and enhance high-speed broadband service to at least 15 million customer locations, most of them rural, within four years of the transaction closing. This expansion is in addition to the broadband expansion plans that AT&T has already announced, and it directly results from the synergies created by the transaction.

First, AT&T will use its wireless spectrum to bring a fast, innovative broadband Internet access service to 13 million customer locations in rural areas in 48 states. Attachment A to this testimony is a map that reflects our best estimate of the coverage of this broadband expansion. More than 80% of these locations will be outside of AT&T's wireline footprint. This is a new "fixed wireless" solution that uses advanced technology, dedicated spectrum, and professional home installations to provide a consistent and reliable high-speed broadband experience at home. We expect this product to perform as well as wireline broadband services advertised today at 15-20 Mbps. Rural customers will be able to purchase this new broadband service, DIRECTV, and IP telephone service with advanced features and larger calling areas as an integrated package or, if they prefer, on a standalone basis. This is big news for rural America. We estimate that nearly

20% of these rural consumers today have no access to a high-speed wireline broadband service, and that another 27% are hostage to only one provider. In the latter case, that single option is often a slower, older generation DSL or cable service. For many, AT&T's new service will be the fastest available, and, for some, their first chance for truly high-speed broadband.

Second, AT&T will expand its "GigaPower" broadband infrastructure. GigaPower is our newest and fastest broadband. It brings fiber all the way to the home and offers speeds of up to 1 *gigabit* per second. The transaction dramatically improves the business case and will allow AT&T to upgrade at least 2 million additional customer locations to fiber. Today, most of those additional locations either have no AT&T broadband or older generation broadband that does not support video. These customer locations will therefore gain not only lightning fast Internet access but an alternative to cable for seamless bundles of broadband, video, and other services.

The Transaction Will Enhance Rather than Reduce Competition

In the vast majority of the country, AT&T and DIRECTV do not compete at all. In those areas, the transaction unambiguously enhances competition because it makes AT&T a stronger competitor and will accelerate innovation and the deployment of new broadband infrastructure.

In the limited areas where AT&T offers video, we are still first and foremost a broadband company. Fewer than 140,000 of our customers (less than 2% of our video base) purchase video on a standalone basis. DIRECTV, on the other hand, is a pure-play video provider. As a result, there is simply no significant competitive overlap between AT&T and DIRECTV in the product that consumers overwhelmingly demand—an integrated broadband/video offering.

This transaction is unlike most mergers because it primarily combines *complementary* products and capabilities. As a matter of economic theory and business reality, when complementary providers join forces, the net result is *downward* pressure on prices and *increased* incentives to invest in innovation, integration, and infrastructure. And in this transaction in particular, econometric analysis confirms that by making us more competitive, the merger will put downward pricing pressure on all cable products—cable bundles, cable video, and cable

broadband—and have a positive impact on consumer welfare, *even before* one accounts for the very substantial cost savings and synergies that the merger makes possible.

AT&T operates in a competitive environment that is only becoming more competitive. The cable companies already dominate both broadband and video. Google Fiber, Netflix, ever-faster mobile wireless services and others are transforming competition on a daily basis. This transaction gives AT&T the combination of capabilities to be a more effective competitor to cable and to anticipate and lead in the fast-changing world of communications and entertainment.

Disrupting Competition and Developing Next Generation Services

One final word about how we together are moving toward a more competitive, innovative communications marketplace. The home-delivered video industry is evolving. The traditional cable companies are focused on maintaining their particular business model that has been dominant for too long, and DIRECTV lacks the broadband capabilities to capture the future. With our core businesses in mobile and fixed broadband, AT&T is positioned to pull the video market into a newly competitive world of integrated, interactive video services delivered anywhere on any device. This transaction lets us start doing that in a meaningful way.

Whether a customer wants to buy broadband or video on a standalone basis or in a bundle, we can serve the customer far better with DIRECTV's products and people than without them, and when this transaction closes, we will follow a sales pattern that is time-tested and proven for us. When we deployed DSL technology, we focused our sales efforts first on our existing base of telephone customers. When we deployed IP broadband, we focused our sales efforts first on our DSL base. And when we deployed U-verse video, we focused first on our IP broadband base. This merger creates even bigger opportunities: DIRECTV has over 20 million video subscribers who will likely be interested in some or all that AT&T has to offer, and we will also offer DIRECTV to all of our existing customers, wireless and wireline, as part of a bundle or, if the customer prefers, as a standalone product. At AT&T, we know how important it is to satisfy customers and preserve opportunities to introduce them to new choices and that drives us to ensure that *all* of our services remain competitively-priced and of the highest quality.

Likewise, because our core business will remain the wireless and wireline delivery of broadband, we will have every incentive to work with, rather than against, the new generation of over the top providers of interactive and video services like Netflix, Amazon, and Google. Our broadband and mobile Internet access services depend on creating and delivering that rich environment of cutting edge content, and that is increasingly so in this new video age.

Finally, AT&T has found that it serves consumers best when our employees and suppliers reflect the diversity of the markets we serve. We will extend our best-in-class diversity practices to the employees and suppliers of the combined company. AT&T also has the largest full-time union workforce of any company in America, and the combined company will continue AT&T's practice of working responsibly with the unions representing its workforce. We are pleased that the Communications Workers of America supports this transaction and has expressed its confidence that regulators will move forward to ensure that the merger's public interest benefits are realized.

Thank you, Mr. Chairman.

ATTACHMENT A



PREPARED STATEMENT OF MICHAEL WHITE

**Testimony of Michael White
President, Chairman, and Chief Executive Officer
DIRECTV
before the
United States Senate Committee on the Judiciary
Subcommittee on Antitrust, Competition Policy and Consumer Rights
June 24, 2014**

Chairwoman Klobuchar, Ranking Member Lee, and members of the subcommittee, my name is Mike White, and I am the President, Chairman, and Chief Executive Officer of DIRECTV. Thank you for asking me to testify on DIRECTV's proposed transaction with AT&T.

I have always passionately believed that, for a business to succeed in the long term, it must continue to satisfy its customers' needs and wants and consistently do so better than the competition. This transaction will help us do just that. It is overwhelmingly about the combination of complementary assets and products. It will create a company that will offer new services at a better value for our customers. And it will help us compete long into the future.

With AT&T, we have the opportunity to combine America's premier video company with a world-class broadband and wireless provider. Both companies rank among the best providers in terms of customer satisfaction today. Combined, we will do what neither company can do on its own. We will:

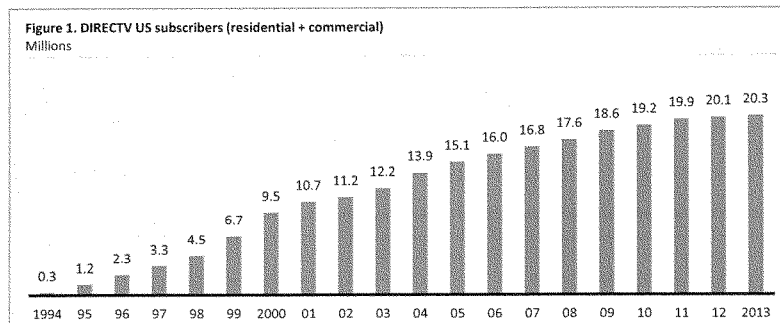
- Offer competitive bundles of services that neither company can offer today, enabling millions of consumers to watch more of what they want, when they want, and where they want.
- Provide new or faster broadband to at least fifteen million customer locations, most of which are located in rural areas.
- Compete more effectively with the cable bundle by creating a new and unique alternative for consumers.

We believe that combining AT&T with DIRECTV will benefit our twenty million subscribers in the U.S. as well as the millions of additional consumers who will have a stronger competitor to choose from.

I. DIRECTV MUST ADAPT TO CONTINUE TO COMPETE IN THE NEW, INTERNET-DRIVEN ECONOMY.

DIRECTV has enjoyed phenomenal growth in its U.S. business in the twenty years since we started service. One reason was early Congressional intervention to assure that the nascent satellite television industry could acquire the programming its subscribers demanded. Another is that we worked hard to deliver more channels, a clearer picture, more advanced equipment, and better customer service than incumbent cable operators.

Three years after launch, DIRECTV had already attracted over three million subscribers—the most successful launch of a consumer electronics product in U.S. history up to that point. By 2005, DIRECTV had grown to 15 million subscribers.



In recent years, however, the market has changed. Bundles have largely replaced pure video. Video itself has combined with the Internet to satisfy customers' demands for more video on demand, TV Everywhere, and expanded recording capabilities. Our competitors' advertising highlights our lack of an Internet offering and their speed advantages.

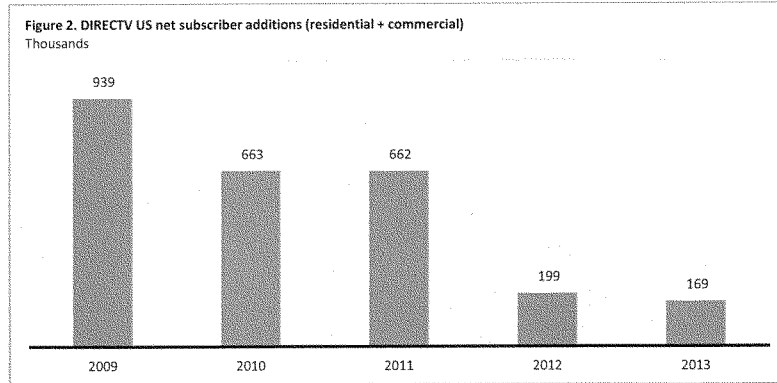


"We left satellite because they couldn't offer a really good Internet package."



"Are you missing out with satellite and slow DSL?"

Not surprisingly, DIRECTV's U.S. subscriber growth has slowed in recent years.



If we want to compete effectively in today's Internet-driven marketplace, we must adapt.

First, we must provide an integrated bundle of services. It should come as no surprise that consumers increasingly demand bundles. According to SNL Kagan, the number of bundled subscribers served by six of the nation's largest cable operators (Comcast, Time Warner Cable, Charter, Cablevision, Mediacom, and Suddenlink) doubled between the second quarters of 2008 and 2013. Today, 78 percent of basic cable subscribers take at least two products (predominantly video and broadband), and 42 percent take three (video, broadband, and telephone).¹

Broadband has supplanted video as the most important element in a customer's service bundle. J.D. Power's 2013 Digital Lifestyle Study, for example, found that "[n]early two-thirds (61%) of consumers consider Internet service as the foundation of their future digital lifestyle

¹ See Tony Lenoir, *Cable's triple-play penetration of basic video subs doubled in the last 5 years*, SNL KAGAN (Sept. 12, 2013).

bundle.”² We must offer our own integrated bundles if we hope to meet this new consumer demand. Otherwise, our subscribers must create their own bundles, generally at higher prices for standalone broadband. (As discussed below, our “synthetic” bundles are not a satisfactory option, either.)

Second, we must serve those who want over-the-top offerings as a complement to or substitute for traditional video service. This was less important five years ago, but it is enormously so today. Netflix now has 36 million U.S. subscribers. Hulu has surpassed 6 million subscribers—more video subscribers than either AT&T or Verizon. SNL Kagan estimates that 45.2 million U.S. households subscribed to online video services as of 2013, more than double the 19.8 million that did so in 2010.³ Unlike our competitors with broadband platforms, we cannot provide our subscribers with access to over-the-top providers. Nor can we combine our own offerings with theirs, at least not without relying on a third-party’s broadband platform.

Third, we must optimize our own video service. Just as non-linear viewing has increased, so too has the use of broadband in connection with traditional video service, especially video on demand and other “non-linear” programming. Our cable rivals can, for example, offer innovative features and services such as remote digital video recorders and video on demand programming stored in the “cloud.” Cable subscribers can watch thousands, perhaps even tens-of-thousands, of films and television programs whenever they want. Soon, cable subscribers will be able to engage other cloud-based features such as “lookback” and integrated Internet and

² Press Release, J.D. Power & Associates, 2013 Digital Lifestyle Study (Aug. 21, 2013), <http://www.jdpower.com/content/press-release/qEdZ9q3/2013-digital-lifestyle-study.htm>.

³ See SNL KAGAN, INTERNET VIDEO-ON-DEMAND REVENUE PROJECTIONS, 2009-2022 (Nov. 2012).

video products. All these and other innovative features will be facilitated by combining DIRECTV's video service with AT&T's broadband capabilities.

Because cable operators increasingly put their functionality in the cloud, moreover, they can improve their service much more quickly and easily. I understand, for example, that Comcast's cloud-based platform has enabled it to make 1200 system updates in the last 12 months. We will need to do the same if we want to keep up.

Fourth, we will have to manage content cost increases. Rising content costs are a challenge for *all* video providers. Yet bundled competitors are better positioned to handle the effects of such price increases because they earn revenue from multiple services, some of which have significantly higher margins than video service. Today, we absorb those price increases into our video business only, which means that we either have to raise prices or curtail investment. Nobody likes to see their bills go up, so we have tried to hold the line on these increases. We can only do so much, however, given the significant power of programmers to increase rates. The efficiencies of a multi-service bundle will help us mitigate the effects of these increases, for the benefit of our customers.

II. DIRECTV HAS HAD LIMITED SUCCESS IN ADDRESSING THESE CHALLENGES ON ITS OWN OR THROUGH CONTRACT.

DIRECTV has attempted to address its lack of a broadband network in various ways. We explored building or acquiring our own broadband network several times. In each case, however, we concluded both that the technology would not be competitive in terms of speed in much of the country and that the capital and other costs involved were so prohibitive that we could not offer consumers a competitively priced product on our own.

Since we could not build or buy our own broadband network, we instead attempted to address this challenge through the creation of synthetic bundles, in which video and broadband

services are provided by separate companies but marketed together to consumers. More specifically, we have formed commercial relationships with a range of providers, including CenturyLink, AT&T, Verizon, and others. Under all of these arrangements, DIRECTV offers to a customer the services of the broadband provider to create a synthetic bundle. DIRECTV receives a commission for each broadband and voice sale it initiates.

Unfortunately, this strategy has proven largely unsuccessful in creating a competitively attractive video and broadband bundle, for two primary reasons:

First, synthetic bundles make for a bad customer experience.

- The initial sales call is difficult. Actually, I should have said “sales calls,” because DIRECTV sales representatives cannot offer a one-call solution. Today, a customer interested in a bundle must first complete her video purchase and then be transferred internally to our “Bundles Desk” to speak with a bundles sales specialist for a broadband price quote and installation scheduling.
- Installation is difficult. DIRECTV is often ready to install a new subscriber’s video service before the broadband provider is ready to install the corresponding broadband service. As a result, customers must arrange separate installations, which need to be scheduled through separate service calls. Then, the customer must wait at home for separate technicians to arrive during separate installation windows, usually on different days. Moreover, when the video installer arrives before the broadband installer, the first installer cannot connect our Internet-enabled set-top boxes. Either the customer or the broadband technician must do so, and they may be unfamiliar with the process or unaware that this connection even needs to be made.

- Billing is difficult. Unlike integrated bundle customers, synthetic bundle subscribers do not receive a single bill for the combined services. Rather, they receive two bills which do not arrive on the same day, and any discounts take a long time to be applied.
- Customer support is difficult. Synthetic bundle customers lack a “one-call” solution to resolve service problems. Rather, they have to deal with two separate companies, which creates a difficult customer service environment.

Second, synthetic bundles are more expensive. The difficulty arises from the fact that two companies are involved in the sale and service rather than one. In any synthetic bundle, each company will seek its own margin on its contribution to the bundled service, making it harder to price the bundle attractively. This may explain why, for example, AT&T prices the broadband and voice components substantially lower when paired with U-verse video versus paired with DIRECTV. The current introductory price for 6 Mbps broadband when paired with U-verse video is \$14.95 versus \$34.95 when paired with DIRECTV. Thus, when viewed in total, the cost to consumers of signing up for an integrated AT&T bundle is substantially less than the cost of signing up with DIRECTV for a synthetic bundle.

IV. THIS TRANSACTION WILL ALLOW THE COMBINED COMPANY TO BETTER SERVE CONSUMERS.

The transaction will combine DIRECTV’s video assets with AT&T’s broadband and wireless assets. This combination of complimentary assets will allow the new company to better serve customers and compete more robustly with the cable bundle.

- **More and better bundles.** The transaction will allow DIRECTV to offer its subscribers integrated bundles of video, broadband, and wireless service for the first time and at a competitive price.⁴
- **Better video.** The transaction will give DIRECTV all of the features and functionalities made possible by a two-way connection, such as greatly expanded video on demand. It will also provide DIRECTV subscribers access to over-the-top service, which may be why Netflix's CFO recently called this transaction a "plus for Netflix."⁵
- **Lower content costs.** The transaction will allow programmers to reach more subscribers on more devices than ever before, unlocking much more value for them than DIRECTV or AT&T could do on their own. This should lead to lower content costs (and, for DIRECTV in particular, the ability to spread those costs over more services).
- **More broadband.** Lower content costs, along with other cost savings and synergies, will permit AT&T to offer more or better broadband to fifteen million locations, many of which are in rural areas.
- **More innovation.** The combination of our video service (and content relationships) with AT&T's wireless subscriber base will dramatically increase innovation to provide new content offerings over the top or on wireless devices.

In short, we at DIRECTV think that combining with AT&T will enable us to meet our greatest challenge and better compete in today's marketplace. We will unlock new growth

⁴ Of course, subscribers who wish to take standalone services—satellite video, fiber video, broadband, or voice—will also be able to do so.

⁵ Joyce Wang, *Netflix Talks AT&T-DirectV, Plans Programming Boost*, CABLEFAX (May 21, 2014), <http://www.cablefax.com/programming/netflix-talks-att-directv-plans-programming-boost>.

opportunities to provide new services to customers at a better value. As we offer subscribers better and more innovative services, cable operators and other competitors will have to respond in kind. The result will be more competition and a better video experience for all Americans.

Again, thank you for allowing me to discuss my enthusiasm for this transaction. I would be happy to take any questions you might have.

PREPARED STATEMENT OF CHRISTOPHER KEYSER



Written Testimony of Christopher Keyser

President

Writers Guild of America, West Inc.

Before the

United States Senate Committee on the Judiciary

Subcommittee on Antitrust, Competition Policy and Consumer Rights

At a Hearing Entitled

“The AT&T/DirecTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond”

June 24, 2014

Introduction

Chairman Klobuchar, Ranking Member Lee and members of the Subcommittee, thank you for the opportunity to appear before you today. My name is Christopher Keyser; I am President of the Writers Guild of America, West, Inc. (WGAW) and a working television writer for the past 25 years.

WGAW is a labor organization that represents more than 8,000 professional writers of film, television and online video programming. Our members write feature films, dramas and comedies for broadcast, cable and pay TV networks, local news, documentary programs and the original series that are now available online through services such as Netflix, Amazon, Hulu and Crackle. Virtually all of the entertainment programming and a significant portion of news programming seen on television and in film are written by WGAW members and the members of our affiliate, Writers Guild of America, East (jointly, "WGA").

The subject of today's hearing, the proposed merger of AT&T and DirecTV and the broader trend towards media consolidation currently underway, threatens the progress of our most vital communication platforms and will stifle the creativity, independence and innovation enabled by online video. The WGAW is opposed to this merger and the Comcast – Time Warner Cable merger, which are taking place against the backdrop of an already consolidated media environment where a handful of companies decide what content consumers can watch. The writers whom I represent have experienced two decades of consolidation, which has reduced a once vibrant market of independent producers to one in which seven companies control almost all of television.

The mergers between incumbent video and Internet service providers (ISPs) are happening at a time when new video competition is emerging online, giving consumers added choice and reintroducing independent programming to the landscape. At the same time, however, multichannel video programming distributors (MVPDs), which are also the largest ISPs, have an incentive to limit the growth of online video alternatives, because such services may pose a threat to existing television offerings. If this merger is approved by regulators, along with the Comcast – Time Warner Cable merger, two companies will control more than half of the nation’s MVPD subscribers and half of the wired Internet access market.¹ The resulting companies would have unprecedented power as content gatekeepers. This consolidation of distributors will likely spur additional consolidation among content providers. In fact, the financial press reports that Univision, AMC Networks and Scripps Networks Interactive are potential acquisition targets.²

The merger between AT&T and DirecTV would combine the second and fifth largest MVPD. The result would be a company with 26 million MVPD customers and 11 million U-verse Internet subscribers, as well as 5.5 million non-U-verse Internet subscribers.³ It would be second in size only to a merged Comcast – Time Warner Cable. A combined AT&T - DirecTV would have significant buyer power to reduce affiliate fees paid to content providers – like broadcast and cable networks - which is a stated goal of the merger.⁴ Because DirecTV offers service nationally, the merger will reduce competition for MVPD service in areas where AT&T’s

¹ Leichtman Research Group, “2.6 Million Added Broadband from Top Cable and Telephone Companies in 2013,” March 17, 2014, <http://www.leichtmanresearch.com/press/031714release.html>, Subscriber information from company filings and SNL Kagan.

² Amol Sharma and Keach Hagey, “Entertainment Companies Scout for Mergers,” *Wall Street Journal*, June 15, 2014, <http://online.wsj.com/articles/entertainment-companies-scout-for-mergers-1402876065>

³ Includes DSL and non-U-verse Internet subscribers. Subscriber information from company filings.

⁴ *Applications of AT&T Inc. and DirecTV for Consent to Assign or Transfer Control of Licenses or Authorizations*, MB Docket No. 14-90, June 11, 2014. Hereinafter referred to as “Application”.

U-verse television service is currently offered, which is approximately 25% of the country. Further, the merged entity's control over traditional and new content distribution platforms will give it both the incentive and the ability to stifle online video competition and limit consumer choice. The Satellite Home Viewer Act and the Telecommunications Act of 1996 embody a legislative intent to enhance competition, but this merger will have the opposite effect. While this combination may serve the corporate interests of AT&T and DirecTV, it does not serve the public interest and should not be approved.

The Current State of Video Competition

The proposed mergers of AT&T – DirecTV and Comcast – Time Warner Cable are unprecedented in their size and scope. On its own, each merger presents significant harm to content providers and consumers, and the effects are magnified because the market for delivery of video programming is already consolidated and lacks sufficient competition at all levels. Broadcast, cable and pay TV networks are owned by a handful of companies. A Government Accountability Office (GAO) report noted that seven companies control 95% of viewing hours on television.⁵ Four companies control two-thirds of the MVPD market.⁶ Cable prices continue to rise because of the lack of competition; the average monthly price of expanded basic cable increased by 4.8% to \$61.63 in 2012, compared to a 2.9% increase in the Consumer Price Index (CPI).⁷ Cable and telephone MVPDs provide wired Internet access, which puts them in control of the only platform that could add competition to the media marketplace. But the ISP market is

⁵ United States Government Accountability Office, "Video Marketplace: Competition is Evolving, and Government Reporting Should be Reevaluated," GAO-13-576, June 25, 2013, p 6.

⁶ SNL Kagan, "U.S. Multichannel Industry Benchmarks," 2013 and "U.S. Cable Subscriber Highlights," 12/13Q, <http://www.snl.com>.

⁷ Federal Communications Commission, "Report on Cable Industry Prices," June 7, 2013, p. 3, Available from FCC website, MM Docket No. 92-266, http://transition.fcc.gov/Daily_Releases/Daily_Business/2013/db0607/DA-13-1319A1.pdf.

also concentrated, with four companies controlling 68% of the Internet access market.⁸ In addition, almost one in three Americans has only a single option for Internet service fast enough to stream videos.⁹ Currently, wireless Internet plans feature low data caps that preclude wireless from being a viable Internet service substitute.

In this consolidated market, independent programming has been all but eliminated. According to WGAW analysis of the broadcast network schedules, only 10% of the 2013 fall primetime lineup was independently produced. This is down from 76% independently produced in 1989, when the Financial Interest and Syndication Rules (Fin-Syn) prohibited broadcast networks from owning the content they aired. In addition, most of the independent programs airing on broadcast television are reality series such as *Dancing with the Stars* and *American Idol*. These programs are typically viewed once and do not generate significant revenue from reruns, syndication and DVD sales in the way scripted programs do. As a result, the broadcast networks are less interested in owning this programming. The proliferation of cable channels has not increased competition; the five companies which own broadcast networks also own most of the major basic cable networks. When the WGAW examined the original comedies and dramas offered by basic cable networks, we found a similarly low and declining amount of independently produced series. Over the past five seasons, independently produced series have declined from 41% of basic cable dramas and comedies to only 22%.

The decline in independent programming has reduced the number of potential employers for writers. In 1989, 89% of TV writing jobs and 88% of TV writing compensation came from

⁸ Leichtman Research Group, "2.6 Million Added Broadband from Top Cable and Telephone Companies in 2013," March 17, 2014, <http://www.leichtmanresearch.com/press/031714release.html>.

⁹ FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *Internet Access Services: Status as of December 31, 2012*, December 2013, p 9.

outside the conglomerates. By 2013, those figures have declined to 25% and 14%, respectively.¹⁰ The pivotal moment was the repeal of the Fin-Syn Rules in the 1990s. Despite the expansion of television outlets, both jobs and compensation have shifted from independent studios and production companies to vertically integrated media conglomerates.

The consolidation has caused considerable harm to the creative community. The market power possessed by these media conglomerates allows them to capture a majority of the economic value created by television production, to the detriment of actual content creators. Studios, now guaranteed distribution by virtue of having vertically integrated with networks, no longer compete for talent as a means of differentiation. The inordinate power held by these media conglomerates allows them to make increasing demands on the talent community. The result is that writers must do more work for less pay. For example, writers are now required to invest their time and bear the risk of developing new creative works, a function once compensated in a more competitive era.

Internet Distribution Enables New Video Competition

Online video offerings, which have become increasingly robust, have the potential to reverse the detrimental effects of media consolidation by increasing competition, reintroducing independent programming and expanding consumer choice. 2013 saw the debut of original television-length programming from outside the television ecosystem as Netflix and Amazon began offering original drama and comedy series directly to consumers. The Netflix original series *House of Cards* won three Emmy awards in 2013, the first online video series to win a

¹⁰ These figures include all broadcast, cable and pay TV programming written by WGAW members, not just prime time.

television award.¹¹ Xbox and Playstation are set to become the next online providers to offer original programming.¹² That much of the original content produced for these new outlets comes from independent producers unaffiliated with a television network, including Media Rights Capital, Lionsgate, Sony and Gaumont International Television, further enhances competition.

Internet distribution has not only brought about new programming choices, it has also addressed consumer concerns about pricing and flexibility. For instance, a Netflix or Hulu Plus subscription is available for only \$7.99 a month and both offer thousands of on-demand video choices. While these services are not substitutes for an MVPD, because they must rely on a third-party ISP to reach consumers, they do provide additional competition to traditional television networks. Further, the ability to watch news online through a service such as Bloomberg Television and subscribe to online sports packages from Major League Baseball and The Tennis Channel begin to create the possibility for consumers to build their own, more flexible content bundles. Such a development reclaims some control for consumers who would otherwise have no alternative but to pay the ever-increasing cost of a bundled cable and Internet package.

Incumbent Response: Merger Mania

In February of this year Comcast – Time Warner Cable announced their planned union. In written testimony to the Senate Judiciary Committee, Comcast Executive Vice President David Cohen listed a host of companies, including AT&T and DirecTV, as rationale for the

¹¹ T.C. Sottek, "Netflix challenges the TV establishment with Emmy wins for 'House of Cards'," *The Verge*, September 22, 2013, <http://www.theverge.com/2013/9/22/4759754/netflix-challenges-the-tv-establishment-with-emmy-wins-for-house-of>.

¹² Nellie Andreeva, "XBox Develops Pro Skater Comedy Series," *Deadline Hollywood*, December 6, 2013, <http://www.deadline.com/2013/12/xbox-develops-pro-skaters-comedy-series/>, and Marc Graser, "Microsoft to Launch First Original Shows on Xbox in Early 2014," *Variety*, December 13, 2013 <http://variety.com/2013/digital/news/microsoft-to-launch-first-original-shows-on-xbox-in-early-2014-1200953110/#>, and Nellie Andreeva, "Xbox Developing 1990s Music Series Based on Rapper Nas' Life," *Deadline Hollywood*, February 11, 2014, <http://www.deadline.com/2014/02/xbox-developing-1990s-comedy-series-based-on-rapper-nas-life/>, and Bryan Bishop, "Sony's first original TV series for Playstation will be 'Powers,'" *The Verge*, March 19, 2014, <http://www.theverge.com/2014/3/19/5527878/sonys-first-original-tv-series-for-the-playstation-will-be-powers>.

merger.¹³ In May, AT&T and DirecTV announced their plans to merge. In their public interest statement filed with the FCC, AT&T and DirecTV claim the merger is necessary to compete with a merged Comcast - TWC.¹⁴

AT&T - DirecTV

The merger of AT&T and DirecTV would create the nation's second largest MVPD and ISP. With 26 million MVPD subscribers, the merged entity would control one-quarter of the market, giving it significant power over television networks. With control over such a sizeable share of the market, AT&T – DirecTV would be able to force television networks to agree to rates below market value. In fact, the companies have stated that lowering video costs is one of the key factors motivating the merger. By becoming the second largest MVPD, AT&T – DirecTV would have the power to cut content costs. The companies say they expect to reduce per subscriber content costs by 20%.¹⁵

The distributors' professed goal of cutting costs is a significant concern because affiliate fees paid by DirecTV, AT&T and other MVPDs to television networks have led to the rise of original dramatic programming across basic cable. This has led to new creative opportunities for WGA members and new content choices for consumers. At least two dozen cable networks are now developing and airing original comedies and dramas. Due in part to the investment in original programming, basic cable now accounts for 70% of adult primetime viewers.¹⁶ AT&T – DirecTV's plans to significantly cut these costs will reduce the amount of revenue available to

¹³ *Examining the Comcast-Time Warner Cable Merger and the Impact on Consumers, Before the U.S. Senate Committee on the Judiciary*, 113th Cong. 1 (April 9, 2014) (Joint statement of David L. Cohen, Executive Vice President, Comcast Corporation and Arthur T. Minson, Jr., Executive Vice President & Chief Financial Officer, Time Warner Cable).

¹⁴ Application pp. 4, 23, 24.

¹⁵ Application p. 36.

¹⁶ Michael O'Connell, "Cable 2013 Ratings: Banner Year for AMC and A&E as History Drops," *The Hollywood Reporter*, December 12, 2013, <http://www.hollywoodreporter.com/live-feed/cable-2013-ratings-banner-year-665133>.

invest in programming, harming content creators and reducing choice for consumers. The enhanced buyer power can also harm competing MVPDs because programmers may attempt to raise prices for rival MVPDs to make up for revenue lost from AT&T – DirecTV.

The merging of DirecTV’s MVPD service with AT&T’s MVPD, wireline Internet and wireless services also would significantly increase the new company’s incentive to stifle the development of competing online video services. With 26 million MVPD subscribers, the merged entity’s strategic business priority will be to maintain existing subscriber levels. In addition, the recent formation of a \$500 million venture with the Chernin Group, “to acquire, invest in and launch over-the-top (OTT) video services” will incentivize the company to prefer services it owns over unaffiliated offerings.¹⁷ AT&T’s share of the wired Internet market and its position as the largest wireless provider will enable it to steer the development of the online video market. It can do so by exerting bottleneck power to raise edge providers’ cost of access to AT&T Internet subscribers and by instituting practices that favor affiliated content over outside competitors. For example, AT&T has already come out in favor of paid prioritization in the current debate over new Open Internet rules.¹⁸

AT&T also has a history of questionable practices regarding customer access to applications of their choice. In 2012, the company said it would block FaceTime for iPhone users unless they subscribed to a more expensive text-and-voice plan.¹⁹ It backed away from the

¹⁷ “The Chernin Group and AT&T Create New Venture to Acquire, Invest In and Launch Online Video Business,” AT&T press release, April 22, 2014, AT&T website, http://about.att.com/story/the_chernin_group_and_att_create_new_venture_to_acquire_invest_in_and_launch_online_video_businesses.html, accessed June 18, 2014.

¹⁸ Comments of AT&T Services, Inc., “In the Matter of Protecting and Promoting the Open Internet,” GN Docket 14-28, p15.

¹⁹ Ina Fried, “AT&T: We’re Not Violating Net Neutrality by Limiting FaceTime over Cellular,” *All Things Digital*, August 22, 2012, <http://allthingsd.com/20120822/att-were-not-violating-net-neutrality-by-limiting-facetime-over-cellular/>.

practice only after public outcry.²⁰ In 2013, AT&T also blocked mobile access to Google Hangouts unless the user had a shared data plan.²¹ While these examples of discriminatory behavior occurred on wireless networks, where the FCC failed to apply all of the 2010 Open Internet rules, these examples demonstrate the kind of behavior AT&T would like to engage in.

AT&T is also the largest wireless service provider, with 35% of the mobile market. The company holds 39% of low-frequency spectrum and has said it plans to invest \$9 billion to expand its spectrum holdings in the upcoming incentive auctions. To date, wireless has not been a viable platform for video, but as technology advances and additional spectrum is put into use, the wireless video market will develop. However, with AT&T as the dominant provider in a duopoly market that is not required to abide by all Open Internet rules, AT&T can act as a powerful content gatekeeper.

The conditions offered by AT&T – DirecTV provide little protection against the harms of this merger. The companies offer to provide standalone Internet service at a reasonable price for only three years. Moreover, the service offered--at least 6 Mbps downstream--is at the lower end of broadband speeds. The offer to expand Internet service to 15 million customer locations also deserves a fair amount of skepticism. An initial concern is that only 2 million locations will receive a fiber connection. The remaining 13 million will be connected through Wireless Local Loop (WLL).²² AT&T has failed to follow through on Internet deployment commitments in the past. As a condition of the BellSouth merger, AT&T promised to offer broadband Internet to every customer in its territory by the end of 2007. This promise was not fulfilled, and even five

²⁰Brendan Sasso, "AT&T backs down from FaceTime restrictions following net-neutrality complains," *The Hill*, November 8, 2012, <http://thehill.com/policy/technology/266937-atat-backs-down-from-facetime-restriction-following-net-neutrality-complaints>.

²¹ William Neilson Jr, "AT&T reiterates they are for Net Neutrality, except for when they're not," *Android Authority*, June 9, 2014, <http://www.androidauthority.com/att-reiterates-net-neutrality-except-theyre-390682/>.

²² Application p. 5.

years after the deadline some customers were still waiting for the service.²³ Finally, the offer to temporarily abide by the FCC's 2010 Open Internet Rules similarly provides little protection. Under these rules, ISPs such as Comcast have been able to institute discriminatory data caps and use bottleneck power to extract arbitrary interconnection tolls from Netflix. The rules simply do not go far enough to protect online video competition and do not extend to wireless services, a market AT&T dominates. Not only are the public benefits in this transaction minimal, but AT&T's recent history suggests that it may not follow through with public interest obligations once the merger is approved.

Conclusion

In conclusion, it is clear that we have reached a crossroads. The amount of consolidation that has taken place and is still underway is breathtaking. If both the Comcast – Time Warner Cable and AT&T – DirecTV mergers are approved, the two companies will control half of the MVPD and ISP markets. What's left of those markets is sure to be gobbled up in similar fashion. Where does that leave consumers, entrepreneurs and the creative community? This level of concentration among a few giant distributors makes inevitable tacit collusion on price, choice and service. These mergers cannot be managed with conditions that may be ineffective, insufficient or simply ignored. They are not in the public interest, they threaten to stifle competition and innovation, and they should not be approved.

²³ Gerry Smith, "Many Rural AT&T Customers Still Lack High-Speed Internet Despite Merger Promise," *Huffington Post*, November 18, 2012, http://www.huffingtonpost.com/2012/11/18/rural-att-customers-merger-Internet_n_1914508.html.

PREPARED STATEMENT OF MATTHEW F. WOOD



Written Testimony of

Matthew F. Wood
Policy Director
Free Press

before the

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Subcommittee on Antitrust, Competition Policy and Consumer Rights

regarding

**“The AT&T/DIRECTV Merger: The Impact on Competition and
Consumers in the Video Market and Beyond”**

June 24, 2014

INTRODUCTION

Chairman Klobuchar, Ranking Member Lee, and esteemed members of the Subcommittee, it is a pleasure to be called here again. Thank you inviting me to testify on “The AT&T/DIRECTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond.”

Free Press is a nationwide, nonpartisan and non-profit organization with more than 750,000 members in the United States and around the world. We work for public interest media and technology policies intended to strengthen our democracy by improving the communications channels that people use for free expression, educational achievement, and economic activity.

We advocate for diverse ownership, and focus especially on promoting open, universal and affordable Internet access and communications platforms. We keep a watchful eye on consolidation and concentration in the telecommunications and media sectors. We’ve had quite an eyeful lately. This merger is but one of many already proposed this year or rumored to be in the works in the near future.

Combined, these transactions would remake the nation’s communications landscape. But make no mistake: already, that landscape is far from a level playing field. It is full of almost insurmountable barriers to entry, with precipitously high prices and rapidly declining choices. The mega-deals under consideration this year would work seismic shifts in a marketplace already too difficult for consumers to navigate.

The AT&T/DIRECTV combination in particular would result in highly concentrated pay-TV markets everywhere that AT&T offers video service today, as it tries to take over (and take out) one of the largest multichannel video providers in the country. AT&T suggests it would experience savings on its own video acquisition costs as a result, though most analysts believe AT&T is vastly overstating the extent of those savings. More important than the overstatement, however, AT&T nowhere commits that customers of the combined company would share these savings in the form of lower retail prices.

Instead, AT&T implausibly claims that customers would benefit from improved service and more robust competition in the form of better service “bundles.” It also repeats its past promise to provide broadband to more customers and regions, recycling the claims it has made in attempts to gain approval for several mergers before this one. AT&T never pauses to explain adequately whether it fulfilled those earlier promises, or if it did, how its new assurances do anything to enlarge its prior commitments. And it conveniently ignores the wasted opportunity for our nation, and the kind of real and game-changing broadband upgrades it could build with the nearly \$70 billion on the table for this merger.

In sum, there is no good explanation for this merger between the nation’s second largest multichannel video provider in DIRECTV, and its largest phone, largest telco pay-TV, second largest wired broadband and second largest wireless provider all under one roof at AT&T. There is nothing to this transaction but more concentration, less competition, and the same old string of promises used to sell such bad deals to the public.

Deal After Deal, the AT&T Merger Playbook Remains the Same

As it does invariably each and every time it goes on a shopping spree, AT&T comes before you today bearing promises. It also comes here hoping to find you in possession of a high degree of credulity and a very short memory.

How else to explain AT&T's counterintuitive claim that eliminating competitors is the recipe for more competition? Or to explain the fact that it has made this same claim before, yet trots out the disproven hypothesis once again?

How else to explain the fact that AT&T suggests merger-specific benefits that, in fact, either have nothing to do with this merger or provide no discernible benefits to its current and would-be customers? Or that it has made the very same promises before, about expanded broadband deployment in exchange for giant acquisitions, in conjunction with deals stretching back over the past decade?

AT&T may think that this esteemed Subcommittee is gullible, just as it may think that the antitrust agencies and the Federal Communications Commission have already forgotten the last time they heard such claims in connection with an AT&T transaction, just three short years ago. But I hold a different belief.

I believe that when Members of this Subcommittee hear someone say the only way to promote competition is to kill it, each of you understand just how hollow that claim really is. I believe that when you hear someone say we need less video competition in order to get more broadband deployment, it leaves you rightly wondering why that would be the case.

Finally, I believe that when you see the same company appear before you time and again, each time promising that more broadband is just around the corner – that it is always just one more merger approval away – you wonder if you haven't heard before the exact same promises about rural broadband coverage, speeds, and capacity. You know enough to look under the hood of such claims, knowing that you should never trust a used car based on the fancy new paint job alone. That's especially true on a deal like this, with so many miles on its retread claims.

I. THE DEAL WOULD RESULT IN HIGHLY CONCENTRATED VIDEO MARKETS

The proposed combination of AT&T and DIRECTV plainly is a horizontal merger, in an already concentrated multichannel video market. Joining these two companies together would present a textbook violation of the Department of Justice's and Federal Trade Commission's Horizontal Merger Guidelines.¹ The outcome would be what antitrust authorities describe as a "highly concentrated" pay-TV market in 64 separate television markets, where nearly all of AT&T's video subscribers reside, with a presumption of enhanced market power that encourages firms to "raise price, reduce output, diminish innovation or otherwise harm customers."²

¹ U.S. Department of Justice and Federal Trade Commission, "Horizontal Merger Guidelines," Aug. 19, 2010, <http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf> (hereinafter, *Merger Guidelines*).

² *Id.* at 2.

Is there any real benefit from this outcome, in exchange for concentration numbers and prices going through the roof? AT&T and DIRECTV have professed confidence about gaining regulatory approval for this transaction. Their confidence may be misplaced as antitrust authorities and the FCC dig deeper into the deal and its nonexistent public interest benefits.

Herfindahl-Hirschman Index Analysis Explained

When assessing combinations between competitors, the *Merger Guidelines* use the well known Herfindahl-Hirschman Index (or “HHI”).³ Regulators use this tool to evaluate whether the transaction is likely to be anticompetitive. The HHI is a measure of market concentration that factors in the number of firms in a given industry and their respective market shares, calculating the final index number by squaring and then summing the companies’ respective market shares.

For example, DOJ considers markets with an HHI below 1,500 to be “unconcentrated.”⁴ This is equivalent to a market with roughly seven firms of equal size, and a merger in such a situation would cause few competitive concerns. Conversely, markets with HHIs above 2,500 are considered “highly concentrated.”⁵ This is equivalent to a market with four equal-sized firms (or one with just a couple of very large firms and a number of much smaller ones).

Mergers that take place in or that result in markets with this high level of concentration are concerning, as they usually enhance market power. Consider the AT&T/T-Mobile transaction that DOJ rightly moved to block at the end of August 2011: the post-merger HHI on the national level would have been 3,100, an increase of nearly 700 points from the pre-merger value.⁶

According to the *Merger Guidelines*, “[m]ergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed [] likely to enhance market power.”⁷ These guidelines are not “a rigid screen,”⁸ nor the end of the discussion; but DOJ looks skeptically on any deal that concentrates markets to this level and presents such a high likelihood of problematic dynamics arising from the transaction.

HHI Analysis Shows Clear Violations in Every Major AT&T Pay-TV Market

The AT&T-DIRECTV deal before you now fares poorly on the *Merger Guidelines* tests, to put it mildly. To understand how poorly, we define the geographic product market locally rather than nationally, as antitrust authorities typically do for horizontal pay-TV mergers, because customers can only buy the multichannel video services that are available at their physical locations.

³ See *id.* at 18; see also U.S. Department of Justice, “Herfindahl-Hirschman Index,” Merger Enforcement Public Documents, at <http://www.justice.gov/atr/public/guidelines/hhi.html> (last visited June 22, 2014).

⁴ See *Merger Guidelines* at 19.

⁵ See *id.*

⁶ *U.S. v. AT&T Inc.*, Case 1:11-cv-01560, Complaint, ¶ 25 (D.D.C. filed Aug. 31, 2011) (*AT&T/T-Mobile Complaint*).

⁷ *Merger Guidelines* at 19.

⁸ *Id.*

In many instances, antitrust authorities will look at the same geographic area that advertisers do – the so-called television Designated Market Area (or “DMA”). There are 210 such media markets in the United States, ranging from very large (the nearly 7.5 million TV homes in the New York City metro area) to very small (Glendive, Mont., and its 4,260 households).

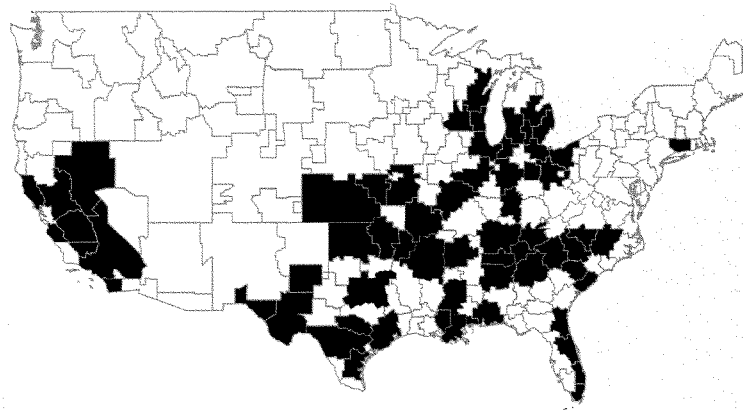
AT&T offers its U-verse pay-TV service in several dozen DMAs. About 99 percent of its television subscribers reside in 64 of the nation’s 210 DMAs. And in each and every one of these markets, AT&T’s takeover of DirecTV violates the *Merger Guidelines*.

In 61 DMAs, the deal would increase the market’s HHI value by more than 200 points and result in a highly concentrated market (meaning a total HHI over 2,500). That indicates this deal is “presumed to be likely to enhance market power,” and “likely to encourage one or more firms to raise price, reduce output, diminish innovation, or otherwise harm customers as a result of diminished competitive constraints or incentives.”⁹

In the other three DMAs making up AT&T’s 64 main U-verse television markets, the deal would result in a post-merger HHI above 2,500 and increase the HHI between 100 and 200 points. This smaller increase doesn’t mean there’s nothing to worry about, as the *Merger Guidelines* say such transactions “potentially raise significant competitive concerns and often warrant scrutiny.”¹⁰

Half of the U.S. population resides in these 64 markets, though AT&T currently offers U-verse TV service to a portion of the homes in these areas, totaling about 20 percent of all U.S. homes.

**The AT&T-DirecTV deal violates The Department of Justice
 Horizontal Merger Guidelines in 64 markets.**



⁹ *Id.* at 2.

¹⁰ *Id.* at 19.

For these 64 DMAs where AT&T offers its own pay-TV service already,¹¹ the DIRECTV deal would increase the HHI by an average of 450 points and result in an average HHI above 3,300.

Yet even that likely understates the true impact of this merger. In any given DMA, there may be multiple pay-TV providers that don't actually compete directly. For example, in the Dallas market (AT&T's home town) the major cable company is Time Warner Cable; but some areas in that DMA are served instead by Charter or Suddenlink. In general, many people today have access to at most one traditional cable company (like the three named just above); two satellite companies (DirecTV and DISH Network); and, for only a third of the country, the incumbent phone company's pay-TV service (e.g., AT&T U-verse, Verizon FiOS, CenturyLink Prism TV).

Yet satellite providers offer service *everywhere*, in every geographic market in the United States, because they are not constrained by the need to run a wire to every house they serve. Although AT&T does not offer U-verse pay-TV service everywhere that AT&T offers telephone and Internet service, U-verse faces video competition from DirecTV everywhere that AT&T offers it. When the non-overlapping service areas of cable companies are taken into account, the deal could increase HHI by more than 1,000 points, resulting in a post-merger HHI of nearly 4,000.

For multichannel video consumers that live in these 64 DMAs, this is a recipe for terrible service and higher prices. It's also bad for the rest of the country, too, as AT&T, with its less than stellar reputation for customer service and innovation, will become a nationwide satellite TV provider. The Department of Justice rejected AT&T's bid for T-Mobile deal in part because it found a reduction in the number of "providers from four to three, likely will lead to lessened competition due to an enhanced risk of anticompetitive coordination."¹²

¹¹ Half of all U.S. TV households are located in these 64 DMAs. However, AT&T does not offer its pay-TV service to all the homes in these markets. U-verse TV is currently marketed to 27 million customer locations, or more than 20 percent of the U.S. The AT&T/DIRECTV merger would result in a highly concentrated market with HHI exceeding 2,500 in all 64 DMAs. In 61 of them, the merger-related change in HHI would exceed 200. Free Press analysis of SNL Kagan subscriber estimates indicates DMAs with HHI increase greater than 200 are (rank-name): 2-Los Angeles, CA, 3-Chicago, IL, 5-Dallas-Ft. Worth, TX, 6-San Francisco-Oakland-San Jose, CA, 9-Atlanta, GA, 10-Houston, TX, 11-Detroit, MI, 16-Miami-Ft. Lauderdale, FL, 18-Orlando-Daytona Beach-Melbourne, FL, 19-Cleveland-Akron (Canton), OH, 20-Sacramento-Stockton-Modesto, CA, 21-St. Louis, MO, 24-Raleigh-Durham (Fayetteville), NC, 25-Charlotte, NC, 26-Indianapolis, IN, 28-San Diego, CA, 29-Nashville, TN, 30-Hartford & New Haven, CT, 31-Kansas City, MO, 32-Columbus, OH, 34-Milwaukee, WI, 36-San Antonio, TX, 37-Greenville-Spartanburg, SC-Asheville, NC-Anderson, SC, 38-West Palm Beach-Ft. Pierce, FL, 39-Grand Rapids-Kalamazoo-Battle Creek, MI, 40-Austin, TX, 41-Oklahoma City, OK, 44-Birmingham (Anniston and Tuscaloosa), AL, 46-Greensboro-High Point-Winston Salem, NC, 48-Jacksonville, FL, 49-Louisville, KY, 50-Memphis, TN, 51-New Orleans, LA, 55-Fresno-Visalia, CA, 56-Little Rock-Pine Bluff, AR, 59-Mobile, AL-Pensacola (Ft. Walton Beach), FL, 60-Tulsa, OK, 61-Knoxville, TN, 64-Dayton, OH, 67-Wichita-Hutchinson, KS-Plus, 70-Green Bay-Appleton, WI, 75-Springfield, MO, 76-Toledo, OH, 77-Columbia, SC, 79-Huntsville-Decatur (Florence), AL, 83-Madison, WI, 91-El Paso, TX (Las Cruces, NM), 93-Baton Rouge, LA, 94-Jackson, MS, 95-Charleston, SC, 96-South Bend-Elkhart, IN, 101-Ft. Smith-Fayetteville-Springdale-Rogers, AR, 107-Reno, NV, 115-Lansing, MI, 125-Monterey-Salinas, CA, 127-Bakersfield, CA, 129-Corpus Christi, TX, 134-Topeka, KS, 143-Lubbock, TX, 150-Odessa-Midland, TX, 160-Biloxi-Gulfport, MS. DMAs where post-merger HHI would exceed 2,500 and the change in HHI would be between 100 and 200 are 68-Flint-Saginaw-Bay City, MI, 84-Champaign & Springfield-Decatur, IL, 87-Chattanooga, TN.

¹² *AT&T/T-Mobile Complaint*, ¶ 36.

The situation with AT&T/DIRECTV is the same: for almost a quarter of the country, this deal would reduce the number of pay-TV competitors from four to three. And the level of market concentration post-merger would be worse in this case than it was in the T-Mobile deal.

AT&T Overstates the Level of Video Competition That Would Survive This Merger

Against these damning HHI numbers, the AT&T/DIRECTV application and public interest showing¹³ filed earlier this month offers two main defenses. Neither is persuasive. The first revolves around video options that will remain to subscribers even if the merger takes place.

AT&T suggests that for standalone multichannel video customers, the market will retain “sufficient competitive options.”¹⁴ The first two subsections of AT&T’s argument on this point dwell on the wonders of bundled service (claims that I will discuss in the next section below), ignoring the impact of increased pay-TV market concentration and the premise that there supposedly would remain “sufficient” alternatives for standalone video customers.

When it gets back to the task at hand, AT&T is largely at a loss to name standalone video alternatives other than the cable and satellite options recited in Free Press’s HHI analysis above. AT&T cites video competition from nascent entrants such as Google Fiber – while noting that Google has only “entered one AT&T U-verse DMA (Kansas City, Kansas/Missouri), and has stated that it will enter a second (Austin, Texas) this year.”¹⁵ It also asserts that AT&T faces “additional competition in a substantial portion of [its] footprint from other competitors that offer video and broadband bundles,” suggesting that such overbuilders “are present in approximately half of the U-verse DMAs” but failing to provide data on just how substantial the number of homes passed and served by such alternatives may be.¹⁶

Finally, as a last alternative for video consumers, AT&T cites over-the-top (or “OTT”) video distributors. This argument conveniently ignore the fact that OTT video alternatives can only be accessed over a wired or wireless broadband connection available from a shrinking number of facilities-based broadband providers such as AT&T.

Thus, the presence of OTT options is cold comfort against concerns about AT&T’s market power. This is so despite AT&T’s commitment to abide by the FCC’s Open Internet rules, recently struck down by the D.C. Circuit Court of Appeals, for a mere three years after closing this transaction.¹⁷ The 2010 rules were full of loopholes, including an utter lack of protections against discrimination on mobile wireless platforms such as AT&T Wireless. Recent negotiations between large ISPs and OTT distributors such Netflix also have shown just how much leverage broadband providers can exercise against over-the-top alternatives even while purporting to make way for them.

¹³ *Applications of AT&T Inc. and DIRECTV for Consent to Assign or Transfer Control of Licenses and Authorizations, Description of Transaction, Public Interest Showing, and Related Demonstrations*, MB Docket No. 14-90 (filed June 11, 2014) (hereinafter, the “*Application*”).

¹⁴ *Id.* at 68.

¹⁵ *Id.*, Declaration of Lori M. Lee, ¶ 31.

¹⁶ *Id.*, Declaration of Lori M. Lee, ¶ 38.

¹⁷ *Application* at 51.

The FCC currently proposes to adopt successor Open Internet rules that could permit “substantial room for individualized bargaining and discrimination in terms.”¹⁸ Enter AT&T, promising in a declaration from its Chief Strategy Officer attached to this Application that the combined company could “partner” and, perhaps, individually negotiate, “more effectively with content providers to follow consumer demand for OTT video.”¹⁹ And if AT&T truly were committed to providing open pathways for third-party OTT video, it is not clear what that would have to do with the “nationwide base of video customers”²⁰ it wants to capture from DIRECTV.

In any event, with respect to facilities-based pay-TV competition, the availability of OTT video may incentivize cord-cutting behavior by a growing number of consumers who no longer wish to pay for both a pay-TV and a home broadband subscription; but that number is still small compared to the number of pay-TV subscribers. That is why the cord-cutting phenomenon cannot completely alleviate concerns about increased concentration in the pay-TV market that would result here from combining the second and fifth largest multichannel video providers, with the market-by-market concentration outcomes and enhanced market power illustrated above.

AT&T’s “Integrated Bundle” Product Market Definition Does Not Alleviate Concerns

AT&T spends more time by far not on illustrating the competitive video alternatives it supposes would remain after the transaction, but on trying to define its way out of this competition problem altogether. In essence, it argues throughout the Application that AT&T and DIRECTV do not truly compete today for video customers because DIRECTV offers a standalone video product while AT&T focuses on bundling video with broadband and wireless service.²¹

In typical AT&T fashion, the company’s hired economics expert refers to concerns about video market concentration as “naïve,”²² dismissing them as AT&T once attempted to brush aside similar concerns with its claims that T-Mobile was not a particularly close competitor either.

Whatever the merits of AT&T’s attempted sleight-of-hand to make the deal’s pay-TV market concentration issues disappear, this line of argument undervalues the utility of what the Application refers to as “synthetic” bundles: those combining DIRECTV satellite video service and “a variety of third-party broadband and/or voice services” from providers including AT&T.²³ The main problem for AT&T in suggesting that a bundle must be assembled and integrated for the customer by a single-source provider, which must own all of the facilities used to offer the bundled products, is the way in which it seems to bundle AT&T and DIRECTV service today.

Why have these combined products, offered to subscribers without the need for combining the two companies outright, not worked “to make significant inroads against the integrated bundle

¹⁸ *Verizon v. FCC*, 740 F.3d 623, 652 (D.C. Cir. 2014).

¹⁹ *Application*, Declaration of John T. Stankey, ¶ 9.

²⁰ *Id.*

²¹ *See, e.g., Application* at 1.

²² *See Application*, Declaration of Michael L. Katz, at 7.

²³ *Application* at 3.

offerings of entrenched cable companies”²⁴ A large part of the reason may be AT&T’s unwillingness to wholesale a competitive broadband product to DIRECTV at a reasonable and competitive price. Were AT&T to do so, or if the FCC had policies in place promoting such resale opportunities, then the “synthetic” bundles that the Application critiques might do just as well as the integrated bundles that this merger promises.

DIRECTV’s Chief Revenue and Marketing Officer notes in his declaration that “AT&T prices [its own] broadband and voice components substantially lower when paired with U-verse video versus paired with DIRECTV. For example, the current introductory price for 6 Mbps broadband when paired with U-verse video is \$14.95 versus \$34.95 when paired with DIRECTV.”²⁵ He concludes that the total price to consumers of an integrated AT&T bundle is substantially less than the price of signing up with DIRECTV for a “synthetic” bundle.²⁶

Could that possibly have anything to do with the fact that the so-called synthetic bundle isn’t such a hot commodity? One might think an unexplained – and frankly indefensible – markup of 133 percent would be enough to explain to both companies’ executives why their joint marketing endeavors are not crushing the cable competition. The higher price, coupled with a hefty \$34.95 price tag for a relatively slow 6 Mbps, might be enough to keep anyone away from DIRECTV’s synthetic, broadband-like service package.

The only attempt to explain such high prices for synthetic bundles comes from AT&T’s economic expert again. As he opines, “economic theory also indicates that ‘because the merger will internalize complementarities, the merged company can be expected to offer a bundle superior to those that they offer through their existing joint marketing arrangement.’”²⁷ What does that mean, precisely? As soon as AT&T can control the whole service bundle, and capture all of the revenues from customers of the combined company, it may no longer impose such a ridiculously large markup on the broadband it bundles with DIRECTV. This deal may be good for AT&T’s bottom line, but it’s certainly not good for customers who’ll see fewer video choices when they could have gotten the same benefits from better competition policies.

These outcomes could be avoided were the FCC to promote resale by limiting how a facilities-based provider can frustrate the development of such arrangements. Resale markets naturally exist in competitive markets, and they “confer[] important public benefits in less competitive markets, including encouraging competitive pricing; discouraging unjust, unreasonable, and unreasonably discriminatory practices; reducing the need for regulatory intervention and concomitant market distortions; promoting innovation; improving carrier management and marketing; generating increased research and development; and positively affecting the growth of the market.”²⁸ The synthetic bundles that the Applicants critique could spring fully to life if AT&T would permit that to happen without the merger.

²⁴ *Id.*

²⁵ *Application*, Declaration of Paul Guyardo, ¶ 29.

²⁶ *Id.*

²⁷ *Application* at 32 n.90 (quoting Declaration of Michael L. Katz, ¶ 62).

²⁸ *Personal Communications Industry Association’s Broadband Personal Communications Services Alliance’s Petition for Forbearance For Broadband Personal Communications Services*, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 13 FCC Rcd 16857, ¶ 32 (1998).

II. EMPTY RHETORIC, BROKEN PROMISES, NOT PUBLIC INTEREST BENEFITS

The benefits of bundles could be replicated with effective resale policy, and without removing a competitor from the market. That means AT&T's claims about the integrated bundle benefits – even if those outcomes were real – should not be viewed as merger-specific benefits offsetting the likely harms from additional concentration. Such benefits could be obtained without removing a competitor from the market.

AT&T offers two other possibilities for merger-specific benefits: reduced programming acquisition costs for its video content, and increased broadband deployment both inside and outside of its wireline footprint. The first one is overstated, with no promise that these program cost savings will be passed along to AT&T customers. The second one really has nothing to do with this deal. It merely restates meager commitments that AT&T has put on the table in one form or another several times in the past decade – leading discerning merger reviewers to ask if AT&T already had planned these rollouts prior to this DIRECTV merger, and also whether the company should have hit these benchmarks already if it had delivered on earlier promises.

Program Cost Savings Uncertain, Overstated, and Unlikely to be Shared by Consumers

According to AT&T, spending so much money on a standalone satellite TV provider all makes sense because the deal would deliver the combined firm \$1.6 billion in cost savings. It attributes the bulk of such savings to reduced video programming acquisition costs, owing to the benefit of increased scale in negotiations with pay-TV channel owners.²⁹

AT&T may be overstating its cost savings in the first instance. Some analysts estimate these at just \$400 million a year.³⁰ Savings at that lower level wouldn't be close to sufficient to justify the deal.³¹ Even at a higher level than AT&T's public prediction of \$1.6 billion, the deal still may not make financial sense for AT&T.³² And while volume discounts for multichannel video providers undoubtedly are real, recent research from SNL Kagan suggests that rising costs for sports programming, broadcast retransmission consent, and the digital rights that bundled providers now seek to obtain all may be eroding the benefits of scale in the pay-TV distributor business.³³

²⁹ See Application, Declaration of Rick L. Moore, ¶¶ 9-10.

³⁰ See, e.g., Stephen Gandel, "AT&T's bid for DirecTV doesn't add up," *Fortune*, May 20, 2014, <http://fortune.com/2014/05/20/atts-bid-for-directv-doesnt-add-up/>; Peter Kafka and Amy Schatz, "AT&T Could Probably Buy DirecTV. But Why?" *Re/Code*, May 1, 2014, <http://recode.net/2014/05/01/att-could-probably-buy-directv-but-why/>.

³¹ See Kafka and Schatz, *supra* note 30 (quoting analyst Craig Moffett).

³² Jeffrey Goldfarb, "AT&T Will Struggle to Justify a Deal for DirecTV," *NY Times Dealbook*, May 14, 2014, <http://dealbook.nytimes.com/2014/05/14/att-will-struggle-to-justify-a-deal-for-directv/>.

³³ See Tony Lenoir, "MSOs log seasonal surge in programming costs in Q1," *SNL Kagan: Multichannel Trends*, June 11, 2014 (reporting that the programming costs of Comcast, the nation's largest multichannel video distributor by number of subscribers, had risen more than the costs incurred by smaller cable operators).

While AT&T's programming costs for U-verse video obviously would go down, AT&T is bringing far fewer subscribers to this deal than DIRECTV is. AT&T's programming costs could decrease by as much as 20 percent according to the company's June 2014 statements to the Securities and Exchange Commission; but that 20 percent applies only to AT&T's U-verse content costs, not the costs of acquiring programming for more than 20 million current DIRECTV subscribers in the United States.

In any event, the programming cost savings are relevant for AT&T's bottom line and its shareholders, but of course that alone is not enough to justify the deal. The key point for this Subcommittee, as for antitrust and communications regulators, is not whether the deal makes financial sense for AT&T but whether its customers will see any benefits from it. The answer is that AT&T makes no real commitment to pass any cost savings along to its subscribers, nor is it likely to do so in a more concentrated and commensurately less competitive pay-TV market.

The Application is replete with references to the “downward pressure” on price about which AT&T's predictions and econometric analyses speculate. Yet, AT&T can't quite bring itself to claim that all of this downward pressure will result in real price savings for consumers. The most definitive claim AT&T seems willing to put on paper appears on a single page in the Application, referencing the economic expert's opinion that “market forces will ensure that the company uses these reduced marginal costs to enhance consumer welfare, whether through reduced prices, improved offerings, new services and capabilities, or a combination of these.”³⁴

Note AT&T's care not to promise reduced prices. The best it can muster is a combination that may include lower prices along with bigger bundles and new services. And the claim that the combined company would face competition in the pay-TV and broadband markets, and thus “have incentives to pass through some” savings, is belied by almost two straight decades of pay-TV price increases across the industry³⁵ – even in markets deemed competitive and served by the largest pay-TV providers with, in theory, the largest volume discounts on their programming.³⁶

AT&T's Broadband Promises Are Underwhelming and All Too Familiar

As explained in detail in Part III below, real network investment would be a much better use of the billions that AT&T proposes to spend on this merger. Yet never shy about parading the same deployment promises in more than one deal, AT&T claims that this pay-TV merger would enable it to invest in broadband. In fact, the company insists the transaction at issue here is what will allow it “to expand and enhance its deployment of both wireline and fixed wireless broadband to at least 15 million customer locations across 48 states, with most of the locations in underserved rural areas.”³⁷

³⁴ Application at 33-34 & n.97 (citing Declaration of Michael L. Katz, ¶ 118).

³⁵ See S. Derek Turner, *Combatting the Cable Cabal: How to Fix America's Broken Video Market*, at 10 (May 2013).

³⁶ See Free Press, “Four Infographics Reveal Why the Comcast Merger Is Bad for You,” Mar. 26, 2014, <http://www.freepress.net/blog/2014/03/26/four-infographics-reveal-why-comcast-merger-bad-you>.

³⁷ Application at 1-2.

Expanding to 15 million customer locations may sound like a lot, until you unpack all of the nuances in this commitment and compare it to AT&T's eerily similar claims from past announcements.

AT&T is not planning to extend U-verse advanced DSL technology or more advanced wireline capabilities to all of those homes. To reach 15 million locations, AT&T says it will "provide [fiber-based] wireline broadband service to 2 million more customer locations" but "fixed wireless local loop ('WLL') technology" for the remaining "13 million largely rural customer locations" in that total.³⁸

Translation: AT&T's broadband solution for rural America is the same expensive, capped, fixed 4G wireless services that it currently offers in areas where it refuses to upgrade its wired networks. This "commitment" doesn't even come close to offering real broadband at future-proofed speeds to these 13 million homes.

Moreover, both the wireless and wireline rollouts likely would have happened without this merger. When AT&T announced its "Project Velocity IP" initiative in November 2012, the company indicated that its 4G LTE network was "expected to cover 300 million people by year-end 2014."³⁹ AT&T is always careful to change the denominator in its promises so that it is difficult to make apples-to-apples comparisons between this 300 million under Project VIP and the lucky 13 million "new" locations that would get fixed WLL service as a result of this merger. AT&T asserts without further explanation that its DIRECTV commitment goes beyond its Project VIP plans,⁴⁰ but the math is anything but clear on the surface of the Application. It is also hard to square with AT&T announcements last month that the company's Wireless Home Phone & Internet service is already available nationwide, in a blog posted just days after the DIRECTV merger was announced but (obviously) long before it has been approved.⁴¹

The suggestion that AT&T must first buy out a competitor before it can afford to improve its broadband coverage, in a plainly horizontal merger that results in a highly concentrated market, is mindful of nothing so much as AT&T's most recent failed takeover of this sort.

In 2011, while trying to persuade regulators of the benefits from its attempted buyout of T-Mobile, AT&T continually recited the preposterous claim that it could not afford to deploy LTE to 97 percent of the country without first spending some \$39 billion on its rival. Just how preposterous that claim was became apparent to the public, however, only when AT&T's attorneys failed to redact this cost that AT&T claimed it could not afford without first acquiring T-Mobile: \$3.8 billion.⁴²

³⁸ *Id.* at 5.

³⁹ See AT&T, Press Release, "AT&T to Invest \$14 Billion to Significantly Expand Wireless and Wireline Broadband Networks, Support Future IP Data Growth and New Services," Nov. 7, 2012, <http://www.att.com/gen/press-room?pid=23506&cdvn=news&newsarticleid=35661&mapcode>.

⁴⁰ See *Application* at 50.

⁴¹ See AT&T Consumer Blog, "AT&T Wireless Home Phone & Internet Goes Nationwide, and So Can You," May 22, 2014, <http://blogs.att.net/consumerblog/story/a7795364>.

⁴² See Letter from Richard L. Rosen, Counsel for AT&T, to Marlene H. Dortch, Esq., Secretary, Federal Communications Commission, WT Docket No. 11-65, at 1-2 (filed Aug. 8, 2011) (redacted for public inspection).

Then as now, it is hard to accept the claim that AT&T can only justify spending on broadband deployment if the government first approves an anticompetitive merger – with a price tag five to ten times higher than the pure investment figure that supposedly makes AT&T blanch.

Before 2011, AT&T successfully closed a different merger while promising to deliver broadband to 100 percent of the housing units located within its wireline territory. In 2006, AT&T's commitments for its BellSouth acquisition detailed plans to serve 85 percent of AT&T's wireline footprint with wired broadband offerings, and the remaining 15 percent with satellite and wireless technologies.⁴³ AT&T today suggests the same kind of comprehensive coverage is possible with newer fiber and 4G technologies only if it is allowed to merge once more. Yet its track record on fulfilling such promises is spotty at best, with residents in its wireline service territory suggesting they were still waiting for AT&T to meet BellSouth merger commitments some six years after those promises were made.⁴⁴

What could AT&T do if it were serious about building a better broadband network? Plenty. It could start by taking the money it wants to throw at this deal and putting it to a better use. AT&T could pass all 115 million homes with gigabit fiber for fraction of the total deal value with DIRECTV. And if it invested the entire amount in fiber, AT&T could do a great deal more.

III. WASTED OPPORTUNITIES TO BUILD A BETTER BROADBAND FUTURE

Immediately after AT&T announced its intent to purchase DIRECTV, my organization labeled this transaction the “most wasteful deal ever” – or at least the most wasteful since Comcast announced its plans to buy Time Warner Cable.⁴⁵ That may sound hyperbolic until you understand the wasted opportunity that this AT&T transaction represents for our country, especially when coupled with the other mega-mergers on tap as we speak.

Were AT&T serious about expanding broadband availability and opportunities throughout its entire service territory – and indeed, throughout the entire country – it would give up on its constant acquisition dreams and concentrate on real broadband expansion and improvements. It might set aside the merger mania mentality that some investors and analysts have adopted and forced on us. That attitude may benefit Wall Street, but it works to the detriment of Main Street.

AT&T Plans to Spend Nearly \$70 Billion Merely to Increase Revenues in the Near-Term

AT&T's announced purchase price for DIRECTV, the nation's largest satellite-TV company, was \$48.5 billion in cash and equity. Yet the total transaction value is much higher, standing at \$67.1 billion after factoring in \$18.6 billion in debt. For this sum, AT&T would get a satellite-

⁴³ See Letter from Robert W. Quinn, Jr., AT&T, to Marlene H. Dortch, Secretary, Federal Communications Commission, WC Docket No. 06-74, ¶ 1 (filed Dec. 28, 2006).

⁴⁴ See Gerry Smith, “Many Rural AT&T Customers Still Lack High-Speed Internet Despite Merger Promise,” *Huff Post Tech*, Nov. 18, 2012, http://www.huffingtonpost.com/2012/11/18/rural-att-customers-merger-internet_n_1914508.html.

⁴⁵ S. Derek Turner, “Why the AT&T-DirectV Deal Is the Dumbest, Most Wasteful Deal Ever (at Least Since Comcast–Time Warner Cable),” May 19, 2014, <http://www.freepress.net/blog/2014/05/19/why-the-att-directv-deal-dumbest-most-wasteful-deal-ever>.

only company with declining profits and no real terrestrial assets. By Free Press's estimates, with the amount of profit DIRECTV brings in each year at about \$2.9 billion, it would take AT&T more than two decades to pay for this merger.

Before the deal had even been finalized, critics were out in full force – and they were right to be. The *New York Times*' Jeffrey Goldfarb wrote on May 14, 2014, that the deal "gives off a whiff of desperation."⁴⁶ He noted the kinds of savings that AT&T would need to wring out of DIRECTV for the transaction to make sense, and argued that "AT&T has been eager to make a big acquisition – seemingly any purchase of a certain size, regardless of strategic rationale," even if its return on investment for a merger were lower than its cost of capital.⁴⁷

Not surprisingly, these independent evaluators of the transaction tell a different story than the merger applicants' employees and experts. The truth is that AT&T's short-term interests are the only things served by this merger, and those benefits are directly tied to making consumers' lives worse. For AT&T, this deal is all about revenue growth, which analysts at Moffett Nathanson rightly decried as a failure of strategy. "If simply buying cash flows is sufficient, AT&T could just as easily buy a pharmaceutical firm. Or a dog-racing track."⁴⁸ Indeed, as Recon Analytics analyst Roger Entner noted, "[t]his deal is about getting more money from the same customers."⁴⁹

What AT&T (and Comcast) Could Do Instead with \$70 Billion

AT&T prefers to grow profits quickly by killing competition, rather than grow its capacity. Buying DIRECTV could accomplish the former, reducing pay-TV choice for at least 20 percent of the U.S. population and spurring higher prices. That is why AT&T wants to make this deal.

What if it were serious about building better broadband for America, instead of reciting the same litany of evasive broadband promises catalogued in Part II of this testimony? It is when the cost of merging is taken into account, and the AT&T acquisition is set next to the planned Comcast acquisition of Time Warner Cable, that the lost opportunity becomes painfully apparent.

These takeovers are a perfect illustration what is wrong with America's telecommunications market. Because for the total price of these two mega-deals, AT&T and Comcast could collectively deploy super-fast gigabit-fiber broadband service to every single home in America.

The \$67 billion AT&T plans to spend on a standalone satellite TV company is staggering, if one takes at face value the claims in the Application about DIRECTV's declining performance and diminishing prospects. What if, instead of buying some short-term revenue growth, AT&T instead invested that money in its core broadband business? In that case, for the total amount

⁴⁶ Goldfarb, *supra* note 32.

⁴⁷ *Id.*

⁴⁸ See Brian Fung, "If AT&T buys DirectTV [sic], it could go head-to-head with Comcast-Time Warner Cable," *Wash. Post "The Switch,"* May 1, 2014, <http://www.washingtonpost.com/blogs/the-switch/wp/2014/05/01/if-att-buys-directtv-it-could-go-head-to-head-with-comcast-time-warner-cable/>.

⁴⁹ See Roger Yu and Mike Snider, "Analysis: Why AT&T wants DirecTV," *USA Today*, May 19, 2014, <http://www.usatoday.com/story/money/business/2014/05/13/att-directv-deal-analysis/9044491/>.

this merger would cost AT&T, the company could triple the size of its current fiber broadband footprint and sign up more video subscribers than DIRECTV currently serves.

According to a variety of sources, including AT&T's own experience⁵⁰ with its U-verse fiber service that is already available to about 31 million customer locations, the cost to wire the entire country with gigabit fiber would be approximately \$140 billion.⁵¹ Fiber deployments come in two parts: first passing and then connecting homes. Fiber is strung past all the houses in a neighborhood. Then, if a customer subscribes, the company connects the customer's house with service. The \$140 billion figure for the entire country is based on an average cost to pass a home with gigabit fiber of \$700.⁵² The subsequent cost to connect a subscriber is about \$800, and much less than that if they just sign up for Internet service instead of Internet plus video.

So for the \$67 billion-plus that it intends to spend here, AT&T could pass 71 million new homes with gigabit fiber, and connect 21 million new subscribers (assuming an industry-average 30 percent take-rate).

Some who would defend AT&T's spending might note that the deal's price tag includes \$18.6 billion in DIRECTV debt, and that all but \$14.55 billion of the remaining amount is made up of AT&T stock. But debt and stock have actual value, and that \$14.55 billion in cash alone would allow for some impressive deployments. Indeed, one estimate placed the cost for Verizon's FiOS project to pass more than 17 million homes with fiber broadband at \$15 billion.⁵³

Failures of Industry Imagination, Spurred by Failures of Statutory Implementation

This transaction makes no real sense in either the short term or the long haul. In contrast to the two decades it would take AT&T to earn its money back from buying DIRECTV, it would take AT&T at most 8 to 10 years to pay for a gigabit-fiber deployment that would serve as many or more video customers than DIRECTV has today. And if instead of that industry-average 30 percent take rate, AT&T were to experience astronomical, near 75 percent sign-up rates like Google is seeing for its fiber services in Kansas City,⁵⁴ then AT&T's making a real investment in broadband would pay for itself in far less time.

At its core this deal shows how unimaginative our country's telecom titans are. Comcast's takeover of Time Warner Cable comes with a total price tag of nearly \$70 billion (\$45 billion in equity plus \$25 billion debt). For that price, Comcast is getting almost 12 million TV/Internet

⁵⁰ See Project VIP Press Release, *supra* note 39.

⁵¹ See, e.g., Jay Yarow, "How Much It Would Cost Google To Become A National Cable Company Like Comcast," *Business Insider*, Dec. 7, 2012, <http://www.businessinsider.com/how-much-it-would-cost-google-to-build-a-cable-network-2012-12>.

⁵² See Dave Burstein, "Fiber Economics – Quick and Dirty," *Fast Net News*, Aug. 11, 2012, <http://fastnetnews.com/fiber-news/175-d/4835-fiber-economics-quick-and-dirty>.

⁵³ See Yarow, *supra* note 51.

⁵⁴ Phillip Dampier, "Uh Oh Time Warner Cable & AT&T: Google Fiber Winning 75% of Customers in Kansas City," *Stop the Cap*, May 6, 2014 (citing Bernstein Research analysis of Google's performance in Kansas City), <http://stopthecap.com/2014/05/06/uh-oh-time-warner-cable-att-google-fiber-winning-75-of-customers-in-kansas-city/>.

customers and infrastructure that reaches 30 million homes. But for \$70 billion, Comcast could deploy gigabit fiber past every single non-rural home in the U.S. and sign up far more customers than it would get from Time Warner Cable.

The \$137 billion price tag of the AT&T and Comcast deals is enormous, and comes within a whisker of the \$140 billion cost to connect every home in the U.S. to gigabit fiber. Moreover, that would be the cost for starting from scratch. AT&T and Comcast already have fiber-fed services that collectively cover 60 percent of the country.

Antitrust authorities, communications regulators, and this Subcommittee must ask why these companies are choosing consolidation over investment. The answer is Wall Street's short-term mindset, combined with lax antitrust enforcement and FCC abdication of its competition policies -- all of which have combined to favor wasteful capital allocation. If our telecom markets were effectively competitive, we'd see companies investing not in expensive buyouts and bailouts, but in better infrastructure to lure new customers.

This waste is a sign of market failure. It's the exact kind of market failure that should set off alarm bells in Washington. The purpose of the 1996 Telecom Act was to spur investment in robust, competitive and open networks that enable new industries and boost competition in existing ones. By now, we were supposed to see incumbents deploying outside of their home markets, much as AT&T promised every time it bought out another Baby Bell company in the last decade -- before it switched its standard merger promise to "more wireless for everyone!"

The FCC and antitrust enforcers at one time had largely abandoned these plans to promote real competition,⁵⁵ and today we see the result. Incumbents generally refuse to build out to compete against each other, and in fact their stock prices are punished when they have the temerity to invest in new infrastructure. Plus with the current state of the FCC's Open Internet proposal, we've lost the legal protections that guaranteed these networks would remain open platforms for competition.

CONCLUSION

The AT&T/DIRECTV deal is another wasteful merger proposal in a season full of them. It would result in a highly concentrated pay-TV market, with no real and discernible offsetting benefits that are specific to this merger. And it would waste an opportunity to provide real broadband advances and next-generation fiber deployments in a much larger swath of the country than the relatively paltry commitments offered up here.

Our nation's antitrust authorities are sworn to prevent deals that lessen competition, and current FCC Chairman Tom Wheeler has stated that his mantra likewise is "competition, competition, competition." These agencies have the power to block these wasteful and anticompetitive deals. Doing so would send the right message to the market giants: If you want growth, you should build it, not buy it.

⁵⁵ See generally S. Derek Turner, *Dismantling Digital Deregulation: Toward a National Broadband Strategy* (May 2009), http://www.freepress.net/sites/default/files/fp-legacy/Dismantling_Digital_Deregulation.pdf.

PREPARED STATEMENT OF LARRY DOWNES

Hearing on “The AT&T/DIRECTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond”

Before the Subcommittee on Antitrust, Competition Policy and Consumer Rights

U.S. Senate

Written Testimony of Larry Downes¹
Project Director
Georgetown University, Center for Business and Public Policy
Washington, DC

June 24, 2014

Chairman Klobuchar, Ranking Member Lee and members of the Subcommittee, thank you for this opportunity to testify on the pending merger between AT&T and DIRECTV.

My name is Larry Downes. Based in Silicon Valley for over twenty years, I am an Internet industry veteran and the author of several books on the information economy, innovation, and the impact of regulation. I have also written extensively on the effect of regulation on the dynamic broadband ecosystem, and in particular the role played by the FCC and local regulators.

Summary

Over the last three years, I have been involved in a research project focused on the changing nature of technology innovation and market disruption, performed in conjunction with the Accenture Institute for High Performance. Our recently published findings demonstrate that technological and market forces have put unprecedented and accelerating pressures on incumbent businesses, especially those subject to a long history of regulatory oversight.

Like many of the industries we studied, the video marketplace, and its cousins in voice and data, is in the midst of a profound and exciting transformation—at least for consumers and

¹ Larry Downes is Project Director of the Evolution of Regulation and Innovation Project at the Georgetown Center for Business and Public Policy. His books include *Unleashing the Killer App* (Harvard Business School Press, 1998), *The Laws of Disruption* (Basic Books, 2009) and *Big Bang Disruption: Strategy in the Age of Devastating Innovation* (Penguin Portfolio, 2014).

entrepreneurs. For multi-channel video programming distributors (MVPDs), including both AT&T and DIRECTV, that transformation poses a daunting triple play of threats to their current business model:

1. The rise of a few very powerful content and distribution companies, including Disney, Fox, and CBS, have weighed the scales in program carriage and other negotiations strongly on the side of the programmers, bloating channel bundles and raising prices for consumers even as many users demand more a la carte solutions.
2. Largely unregulated over-the-top program providers, including Google, Amazon, Apple Aereo and Netflix—as well as hundreds of venture-backed start-ups, entrepreneurs, and even average users—are experimenting with abandon with new technologies and new business models for producing, collecting, distributing and monetizing a cornucopia of new and old programming.
3. In developing strategies both to compete and cooperate with these and other threats both inside and outside the media supply chain, MVPDs are severely constrained by a long history of policy decisions and compromises structured to resolve previous tensions between old business models and new technologies. Taken together, they form a sclerotic tangle of interconnected, contradictory and in many cases counter-productive constraints that limit the ability of MVPDs to adapt to the accelerating pace of technical and business change, often for reasons that no longer serve any public interest.
4. Each transaction, of course, must be evaluated separately on its own merits. This transaction in particular makes sound strategic sense. And it presents few if any of the traditional markers for concern either under antitrust law or the FCC's public interest standard. Competition will be enhanced, not harmed, and consumers will have more, not fewer choices, both now and, assuming the integration of the two companies goes smoothly, in the future.
5. As structured, the transaction also has positive side effects that will accelerate the deployment of better and cheaper broadband networks, help to close what remains of the digital divide, enhance the competitive impact of mobile broadband technologies on wired networks, and reinforce the FCC's open internet goals.

Technology Innovation and Disruption

The true driver of change in the media market—its unmoved mover—is the exploding availability of increasingly better and cheaper core technology components. Nearly fifty years, Intel co-founder Gordon Moore made a startling but prescient prediction that computing technologies, notably semiconductors, would continue to double in power and capacity every 12-18 months while price held constant, an unprecedented economic phenomenon known as Moore's Law,²

Today, Moore's Law continues to operate, and my colleagues in Silicon Valley expect it to continue to do so for the rest of our working lives. Indeed, other core technologies in fields as varied as materials, genetics, optics and energy, are now demonstrating similar properties, though most are in the nascent stages of commercial development.³

In a growing list of industries well beyond the ground zero of computing and communications, exponential improvement in price and performance of digital technologies has led to continued price deflation for commodity components, including chips, memory, storage, sensors, displays, optics and communications capacity, a trend accelerated by economies of scale in the production of over a billion smartphones.

At the same time, these components continue to become smaller and require less power, expanding the range of cost-effective applications. It is now virtually costless to embed some measure of computing capacity into nearly every one of over a trillion items in commerce.

Entrepreneurs are now turning their attention from an Internet of people to the Internet of things, where cloud-based computing will connect us not only to each other but to the world around us, sending and receiving massive volumes of information that, if used wisely, will generate a virtuous circle of economic, social, political and personal gains that will raise the standard of living for everyone.

That deflation, coupled with growing connectivity among consumers across traditional marketing segments, has already changed the dynamics of competition. Consumers have implicitly and explicitly internalized the benefits of Moore's Law, and are quick to punish providers, using social media, user reviews and message boards, who don't make full use of its potential.

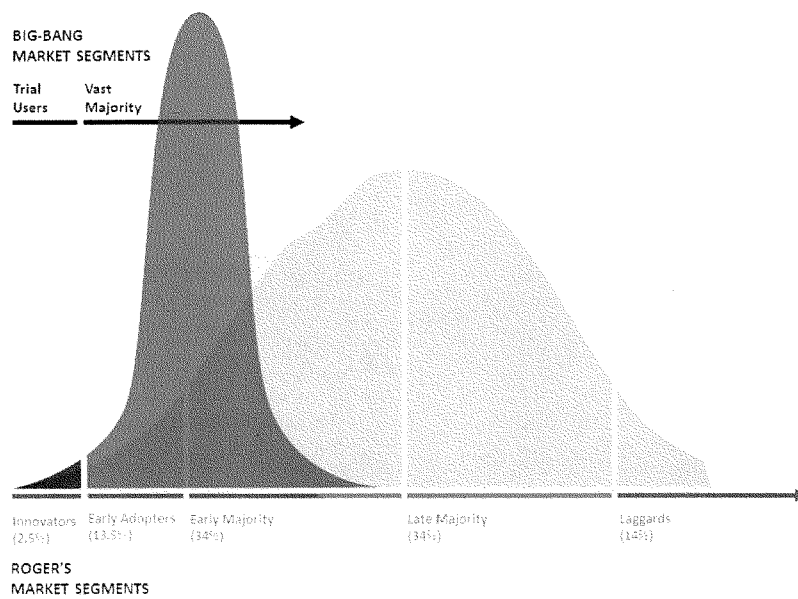
It is now the regular and predictable improvements in technology that dominate the market behaviors of both consumers and producers, providing a more potent form of competitive

² Gordon E. Moore, *Cramming more components onto integrated circuits*, ELECTRONICS MAGAZINE, April 19, 1965.

³ Larry Downes and Paul Nunes, BIG BANG DISRUPTION: STRATEGY IN THE AGE OF DEVASTATING INNOVATION 21-30 (Portfolio 2014)

pressure than any strategic moves by traditional rivals or other participants in mature supply chains.

The traditional life-cycle of new product diffusion, once the placid bell curve made famous by the work of Everett Rogers,⁴ has been squashed and stretched into something that resembles, appropriately enough, a shark fin. (Figure 1) Disruptors appear out of nowhere, saturate the market quickly, and are themselves quickly replaced by the next wave, using the next generation of core technologies.



(Source: *Downes and Nunes*, BIG BANG DISRUPTION)

Figure 1 – The New Model of Technology Adoption

⁴ Everett M. Rogers, *DIFFUSION OF INNOVATIONS* (5th Ed.) (Free Press 2003)

Big Bang Disruption in the Video Market

This phenomenon, which we refer to as “Big Bang Disruption,” is nowhere more visible than it is in markets for computing, communications, and entertainment.⁵ The related trends of technology cost deflation and collective consumer behavior have sped up the pace of change for every participant in the video ecosystem. Providers are now racing to compete not so much with each other as with an inevitable future of constant disruption.

Most significantly, Big Bang Disruption has led to the convergence of vastly different forms of content and specialized networks for transporting them onto the single platform of broadband Internet. We now have genuine competition between cable, satellite, fiber, and hybrid networks, all supporting new products and services that combine video, voice, and data.

Though some technologies are better for some services than others, rapid engineering improvements are taking place across the board, with infrastructure providers investing billions not only to compete with each other but to meet insatiable consumer demand for more of everything, in more forms and combinations and under more business models.

In addition to legacy infrastructure technologies, moreover, the last decade has seen dramatic improvement in mobile broadband networks, super-charged by the release of the iPhone and Android operating systems and the best-in-the-world deployment in the U.S. of 4G LTE networks. Triple plays of broadband video, voice and data are evolving to quadruple plays, adding mobile connectivity.

As both the quality and reach of LTE proliferates from a variety of providers, mobile broadband is becoming a true intermodal competitor for wired broadband in many markets and applications. Cord cutting is a growing phenomenon, except by younger consumers, who never had a cord to cut in the first place.

As a direct result of convergence onto the IP platform, the lines between video, voice and data have been erased, at least as far as consumers are concerned. We watch “TV” on our tablets, and use social media on our television sets to comment on programming as it airs. Standalone voice is giving way to native video conferencing and other forms of collaboration. Content begun on one device is expected to be available on all the others, and the network is expected to keep track of where we were, our playlists and favorites, and to recommend related content and interactivity through the cloud.

Increasingly, consumers want to access the full range of content anytime, anywhere, and on whatever device they happen to be nearest. And with the continued application of Moore’s Law,

⁵ Larry Downes and John W. Mayo, *The Evolution of Innovation and the Evolution of Regulation: Emerging Tensions and Emerging Opportunities in Communications*, presented at FCC “Future of Broadband Regulation” workshop, May 29, 2014 (working paper).

that content and the networks for delivering it will continue to improve in quality, moving from today's high definition standard to 4K or "ultra high definition" and to future innovations, all fueled by continued deflation in core technology costs.

This on-going disruptive innovation in the video market means that predicting future consumer demand has become largely impossible. Preferred forms of bundling and pricing have splintered, for example, with each user increasingly demanding their own unique configuration, one that will change on a whim. In the future, consequently, pricing for premium content will run the gamut from monthly subscription to pay-per-view, with combinations and new business models (such as "freemium" services that offer more or better quality for a fee on top of otherwise free access) yet to be defined.

The Triple Play of Threats Driving Consolidation in the Video Market

With consumers expanding their expectations with each cycle of Moore's Law, mature businesses must become more adaptable and flexible to remain relevant. But incumbents, architected for an earlier era where both forms of content and the networks for delivering it were separate both from an engineering and regulatory standpoint, now regularly find their options unintentionally narrowed by earlier strategic and policy choices. Protected markers are abandoned by consumers who value the new over the stable. Assets, even the crown jewels of the balance sheet, transform quickly into liabilities.

As a result, as our research across industries revealed over and over, consolidation among incumbents is often the essential starting point for incumbents hoping to thrive in the face of new opportunities and new threats posed by this dizzying pace of innovation.

As traditional markets disappear and customers embrace the disruptors, the strongest incumbents look to pool their technical strengths as well as their combined customer bases both to compete with new entrants and to broaden the range of engineering and business innovations they can introduce themselves.

That imperative, at the core, is the true driver of consolidation in the computing, communications and entertainment industries in general and in particular among existing multi-channel video programming distributors (MVPDs).

The video market also demonstrates another common feature in our research. For industries with a long history of regulation, incumbents are even harder-pressed than elsewhere to leverage their remaining assets to compete with unregulated start-ups and other industry outsiders.

In the race to respond to expanding and rapidly-changing consumer requirements, MVPDs, including both AT&T and DIRECTV, find their strategic options constrained by a long history of regulatory and policy compromises. Individually, the resulting regulations were designed to resolve previous tensions between old business models and new technologies. But taken together, the result is a sclerotic tangle of interconnected, contradictory and in many cases counter-productive constraints that no longer serve any public interest.⁶

Unfortunately, as Congress has learned through recent hearings on reforming various aspects of media regulation, it is impossible to pull on just one thread without risking the unraveling of the entire structure.

In the meantime, unfortunately, the rules that apply today to MVPDs, some dependent on the increasingly irrelevant distinctions between broadcast, cable, satellite, copper, and cellular and fiber networks, are now unintentionally slowing the deployment of the new services and new models of delivery that consumers demand. These include regulations regarding must carry, compulsory licenses, financial syndication rules and media ownership restrictions, retransmission consent, network nonduplication, syndicated exclusivity, sports broadcast limits, and set top boxes—just to name a few.

Like zombies, these shadows of former policy decisions good and bad refuse to die, with the unintended effect of hamstringing the ability of MVPDs to keep up with the pace of change.

Consumers, of course, have no intention of living in the past, and entrepreneurs stand by to help them overcome what they see as artificial and inefficient limits. Startups including Aereo, which operate at the very edge (and perhaps, in a case to be determined by the U.S. Supreme Court, over the edge) of a complex web of legal rules and court decisions,⁷ are testing the structural soundness of this system, exposing just how fragile it has become over the years.

⁶ Adam Thierer and Brent Skorup, *VIDEO MARKETPLACE REGULATION: A Primer on the History of Television Regulation and Current Legislative Proposals*, MERCATUS RESEARCH, May, 2014, available at http://mercatus.org/sites/default/files/Thierer_VideoMarketplaceRegulation_v1.pdf. See also Jack Shafer, *Who's Afraid of Comcast?* REUTERS, Feb. 19, 2014, available at <http://blogs.reuters.com/jackshafer/2014/02/19/whos-afraid-of-comcast/>.

⁷ Larry Downes, *AereoTV: Barely Legal by Design*, HARVARD BUSINESS REVIEW, Mar. 7, 2013, available at <http://blogs.hbr.org/2013/03/aereo-tv-barely-legal-by-design/>; Larry Downes, *Aereo's Fate Should be Decided by*

In the face of this growing regulatory burden, new business pressures on regulated MVPDs are now arriving separately and together from two principal disruptors. First, consolidation in the content industry (a function of its own disruptive changes) has tipped the balance in carriage negotiations strongly to the side of the producers. Though details, for sound business reasons, are largely kept private, there's little doubt that programming costs, the largest component of variable cost for MVPDs, have grown dramatically in the last several years, perhaps as much as 50%.

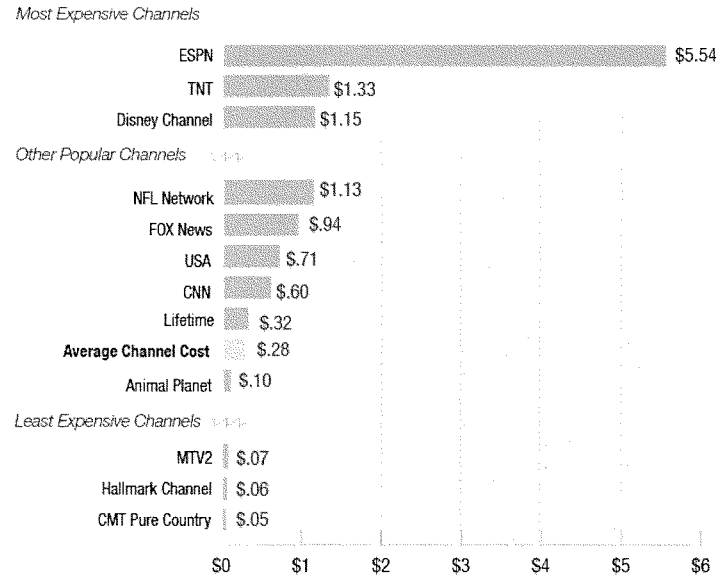
For the most popular produced content, MVPDs have little leverage but to accept the terms offered. And while the FCC finds that overall the average price per channel has declined, the number of channels continues to expand, on average from 44 to 150 since 1995.⁸ Leading content aggregators, including Disney, CBS, and Fox, pressure MVPDs to accept larger bundles of channels at higher prices.⁹ Premium channels carry premium prices, and are often used as bargaining chips to promote less popular content. For example, analysts estimate that cable customers pay as much as \$6 a month just to cover the cost of ESPN--whether they watch it or not.¹⁰ (See Figure 2)

Congress, not the Supreme Court, WASHINGTON POST, April 23, 2014, available at <http://www.washingtonpost.com/blogs/innovations/wp/2014/04/23/aereos-fate-should-be-decided-by-congress-not-the-supreme-court/>.

⁸ Larry Downes, *Why the Case against the Comcast-Time Warner Cable Merger is Evaporating*, CNET NEWS.COM, April 23, 2014, available at <http://www.cnet.com/news/why-the-case-against-the-comcast-time-warner-cable-merger-is-evaporating/>. See also Edward Wyatt, *As Services Expand, Cable Bill Keeps Rising*, THE NEW YORK TIMES, Feb. 14, 2014, available at http://www.nytimes.com/2014/02/15/business/media/as-services-expand-cable-bills-keep-rising.html?_r=1 ("The most recent F.C.C. study on cable industry prices shows that the average monthly price of expanded basic cable service, which had an average of 150 channels, was \$61.63 for the year ended Jan. 1, 2012. That was up from \$22.35 for the same tier of service in 1995, when the average expanded basic service had only 44 channels. So while the total cost increased, the price per channel decreased by about 10 cents.").

⁹ Alex Sherman, *Your Cable Bill is Going up Again, but Forget A La Carte Pricing*, BLOOMBERG, Jan. 13, 2013, available at <http://go.bloomberg.com/tech-blog/2013-01-31-your-cable-bills-going-up-again-but-forget-a-la-carte-pricing/>.

¹⁰ Quoctrung Bui, *The Most (and Least) Expensive Cable Channels, in 1 Graph*, NPR NEWS.COM, Sept. 27, 2013, available at <http://www.npr.org/blogs/money/2013/09/27/226499294/the-most-and-least-expensive-cable-channels-in-1-graph>.



(Source: SNL Kagan)

Figure 2 – Estimated Monthly Cost per Subscriber per Channel (Cable)

The net result is rising prices for consumers, increasing their incentive to cut the cord to MVPD services and look for alternatives. Right on cue, unregulated over-the-top (OTT) content providers are experimenting with abandon, finding new ways to produce, collect, distribute and monetize a cornucopia of new and old programming. Today, more than 50% of American households subscribe to at least one paid OTT service. OTT providers including Hulu, Netflix, iTunes and Amazon already have larger customer bases than the largest MVPDs, and have begun producing their own proprietary, premium programming. Netflix alone has more than 30 million customers in the U.S.

Falling costs for core technologies—including broadband access, hardware and software, also mean consumers themselves now contribute significantly to the overflowing bounty of new

content and access choices in what many rightly call the new Golden Age of Content.¹¹ Everyone can be a producer and, these days, everyone is. Users upload 100 hours of new video every minute just to YouTube¹² and many user channels have viewerships in the millions. Crowdfunding sites including Kickstarter and Indiegogo are flooded with proposals for more elaborate content production, many of which are oversubscribed.

These new models are thriving because consumers want more options than the current regulated industry structure makes possible, or at least at the clock speed of Moore's Law. And when consumers don't get what they want, as has become abundantly clear in recent years, they form alliances with entrepreneurs to revolt, even when doing so brings them into direct conflict with legacy regulations.¹³

The AT&T/DIRECTV Transaction

As explained by our Big Bang Disruption research, the continued deflation of core digital technologies, convergence on IP standards, and the growing ability of consumers to express and influence demand for better and cheaper goods and services, has put tremendous pressure on the entire video ecosystem, particularly for incumbent MVPDs operating under legacy regulations.

Thus I see the proposed transaction, as well as the pending merger of Comcast and Time Warner Cable,¹⁴ as largely defensive moves. MVPDs need larger audiences to improve their bargaining position with programmers, and to achieve economies of scale for the content they license. And to participate in—let alone compete with—the expanding universe of OTT services, no MVPD can long survive without the native ability to integrate broadband Internet with produced content.

To remain competitive, especially with dominant cable MVPDs, AT&T needs the audience DIRECTV has already built. DIRECTV, likewise, needs the broadband network AT&T has built.

¹¹ Larry Downes, *The Comcast-Time Warner Cable Merger is not a Sign of Strength*, HARVARD BUSINESS REVIEW, Feb 14, 2014, available at <http://blogs.hbr.org/2014/02/the-comcast-time-warner-merger-is-not-a-sign-of-strength/>

¹² See "Statistics," available at <https://www.youtube.com/yt/press/statistics.html>.

¹³ Larry Downes, *Uber's Battle in Seattle Highlights the Irony of Regulation Hurting Consumers it was Designed to Help*, WASHINGTON POST, March 24, 2014, available at <http://www.washingtonpost.com/blogs/innovations/wp/2014/03/24/ubers-battle-in-seattle-highlights-the-irony-of-regulation-hurting-the-consumers-it-was-designed-to-help/>.

¹⁴ See Downes, *supra* note 11.

In that regard, consumers of both companies stand to benefit significantly from the transaction, as do consumers as a whole. With a native broadband offering, DIRECTV will remain a viable competitor, enforcing market discipline on cable-based, satellite, and other MVPDs. With a greatly expanded customer base, AT&T will be able to negotiate more equally with programming providers and spread the programming costs of its U-Verse offering over a larger base. The result should be more competitive pressure, both within the supply chain and in the market as a whole.

In the broader context of the industry's on-going digital transformation, the proposed transaction makes sound strategic sense. At the same time, it presents few if any of the traditional markers for concern either under antitrust law or the FCC's public interest standard. Competition will be enhanced, not harmed, and consumers will have more, not fewer choices, both now and, assuming the integration of the two companies goes smoothly, in the future.

The structure of the deal also has two key side-effects I view as positive and worth highlighting:

1. Faster deployment of fiber and fixed wireless technology – AT&T claims the economies of scale the combined company will achieve will generate capital that can be used to accelerate the already-aggressive upgrades and expansion of its broadband networks. Two million additional consumers will have access to fiber, and 13 million additional consumers, largely in underserved rural areas, will have access to high-speed fixed wireless Internet, using wireless local loop (WLL) technology and AT&T's existing 4G LTE network.

That commitment, of course, supports many key policy goals of both Congress and the FCC, including the expanded availability of increasingly robust broadband networks. According to research from the Pew Internet and American Life Project,¹⁵ rural adults are more likely not to use the Internet than any other demographic category. Though relevance is cited far more frequently than availability as the reason they remain offline, improved access will no doubt do much to close what remains of the digital divide.

A large-scale deployment of WLL will also have other positive benefits. For one thing, an investment of this size will invariably lead to innovation and improvement of relatively-new fixed wireless technology, spinning off additional innovations that cannot be predicted. But it is almost certain that better WLL technology will accelerate the speed with which mobile broadband will become a true source of competition with fixed

¹⁵ Pew Research Internet Project, OFFLINE ADULTS, available at <http://www.pewinternet.org/data-trend/internet-use/offline-adults/>. See also Larry Downes, *Who's Still Offline and Why? The Real Reasons*, CNET NEWS.COM, September 30, 2013, available at <http://www.cnet.com/news/whos-still-offline-and-why-the-real-reasons/>.

broadband networks, adding to the pressure on incumbent network operators to innovate with better and cheaper technologies.

2. Commitment to the 2010 Open Internet rules for the combined entity - While some critics felt the FCC's 2010 Open Internet Report and Order did not go far enough toward prophylactically policing broadband Internet providers, there can be no argument that the 2010 rules were at least as strict as those the FCC has recently proposed to replace them.¹⁶

As part of its Public Interest Showing, AT&T has voluntarily committed to make the combined entity subject to the 2010 rules for three years following the completion of the transaction, despite the fact that the bulk of the rules were found to exceed the FCC's authority by the D.C. Circuit Court of Appeals in January, 2014.¹⁷ Comcast, it is worth noting, is already committed, as condition of its 2011 merger with NBC Universal, to a similar version of the rules.

Thus no matter what comes of the current FCC proceeding, two of the three largest ISPs will remain committed to a set of Open Internet rules most participants, including leaders in Congress and in the Internet content industry, felt achieved an appropriate balance.¹⁸

I thank you again for the opportunity to testify and look forward to your questions.

¹⁶ FCC, *In the Matter of Protecting and Preserving the Open Internet*, Notice of Proposed Rulemaking, GN Docket No. 14-28, May 15, 2014, available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2014/db0515/FCC-14-61A1.pdf.

¹⁷ *Verizon v. FCC*, 11-1355 (D.C. Circuit Jan 14, 2014), available at [http://www.cadc.uscourts.gov/internet/opinions.nsf/3AF8B4D938CDEEA685257C6000532062/\\$file/11-1355-1474943.pdf](http://www.cadc.uscourts.gov/internet/opinions.nsf/3AF8B4D938CDEEA685257C6000532062/$file/11-1355-1474943.pdf).

¹⁸ Larry Downes, *Unscrambling the FCC's Net Neutrality Order: Preserving the Open Internet, but Which One?*, 20 COMM LAW CONSPPECTUS 83 (2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2164985.

PREPARED STATEMENT OF ROSS J. LIEBERMAN



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SENIOR VICE PRESIDENT OF GOVERNMENT AFFAIRS
AMERICAN CABLE ASSOCIATION

BEFORE THE
SUBCOMMITTEE ON ANTITRUST, COMPETITION POLICY AND CONSUMER RIGHTS
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

HEARING ON
"THE AT&T/DIRECTV MERGER: THE IMPACT ON COMPETITION AND CONSUMERS
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JUNE 24, 2014

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JUNE 24, 2014

Chairman Klobuchar, Ranking Member Lee and Members of the Subcommittee, my name is Ross J. Lieberman, Senior Vice President of Government Affairs of the American Cable Association ("ACA"). Thank you for inviting me to speak about AT&T Inc.'s ("AT&T") acquisition of DIRECTV, the nation's second largest subscription television provider and owner and manager of popular video programming networks.

We are in the midst of considerable consolidation within both the multichannel video programming distributor ("MVPD") and video programming markets that will have major ramifications for consumers and competition. In 2011, Comcast, the nation's largest MVPD, acquired broadcast and cable programming giant NBCUniversal ("NBCU"). Comcast has now announced plans to grow its MVPD business even larger by acquiring Time Warner Cable ("TWC"), the nation's second-largest cable MVPD, and to divest to and swap systems with Charter Communications to create another industry giant. For the past several years, in a series of deals large television station groups in the broadcast industry have also been merging. Recent reports also indicate that large programmers are looking to get even larger by acquiring mid-sized programmers, like AMC Networks, whose AMC channel is home of the popular "Walking Dead" series, and Scripps Networks, the company behind HGTV and the Food Network. Now AT&T is acquiring DIRECTV. The cumulative impact of these transactions will transform the industry, the competitive marketplace and the consumer experience and should be cause for concern.

Congress, federal and state antitrust authorities and regulators, and local governments each have a critical role in analyzing the pending deals and addressing harms they create, either through divestitures and behavioral remedies or outright denial. In this regard, ACA is pleased that this Subcommittee, which has oversight over antitrust and competition policy, is holding this hearing. But more is needed. In addition to reviewing individual transactions, Congress should review existing rules and regulations to ensure that industrywide problems are addressed so the new market order does not harm consumers by hindering the ability of firms other than the merging parties to compete effectively.

As I discuss below, the proposed AT&T/DIRECTV transaction will increase the incentive of DIRECTV-affiliated programmers to charge higher prices to their rivals, including hundreds of small and medium-sized MVPDs. ACA believes that regulators reviewing the transaction should adopt conditions to head off this potential harm. The deal also highlights existing problems in the video marketplace, such as significant price discrimination in the programming contracts of the large programmers and broadcasters, as well as rules and regulations that do not apply in a

competitively and technologically neutral manner. Congress and the Federal Communications Commission ("FCC") need to ensure that consumers who reside in markets served by smaller MVPDs will not lose any competitive options or see their prices increase as the consolidation wave continues.

I. Introduction to the American Cable Association

In the U.S., nearly 100 million households purchase subscription TV. More than 80 million households subscribe to broadband. While big companies like Comcast, DIRECTV, DISH Network, TWC, AT&T, Verizon, and Charter serve most of the market, there are nearly 850 small and medium-sized MVPDs that provide the "triple play" of video, broadband Internet access, and voice services in local markets in all 50 states to nearly 7 million video subscribers. These are ACA's members. In some instances, these operators provide these same services in markets the big companies have ignored. In other instances, they provide competition to the big operators. ACA members are rarely household names on the national scene. But they are highly valued in the communities they serve. Their local ownership and local focus provides a unique alignment of their incentives to build robust networks and offer valuable programming with the interests and needs of the local communities they serve.

The small and medium-sized operators of ACA – which include cable operators, rural telephone companies, and municipally-owned service providers –, serve a number of important functions in the U.S. communications market and in society at large. ACA members:

Provide broadband in rural areas. As the National Broadband Plan noted in 2010, providing rural broadband is one of the great infrastructure challenges of the 21st century. Despite the high costs of building networks in more sparsely populated areas, ACA members have been building out broadband in rural areas for years. Most of them do so without any government funding, saving taxpayers billions in support for government-funded broadband networks.

Provide competition and choice in urban areas. Some of ACA's biggest members, like WOW!, RCN, Wave Broadband, and Grande Communications, are competitive providers of cable, broadband, and voice services in urban areas. These companies entered markets that are dominated by large cable companies and incumbent telephone companies, bringing choice and price competition in the process. Today, ACA members provide choice to more than five million residences in the U.S.

Provide services to community institutions and business in underserved areas. ACA members make available high-speed Internet access, private data networks and multiline voice products to tens of thousands of community institutions in small cities and rural areas. Nearly one million small businesses in rural areas have access to these advanced communications products from ACA members.

II. AT&T, DIRECTV, and the Competitive Landscape

AT&T and DIRECTV are both participants in the MVPD industry, which distributes video programming to consumers. DIRECTV also participates in the related video programming market, which provides this programming to these distributors.

AT&T is the fifth-largest MVPD. It is an IPTV MVPD operating under the U-verse brand, with about 5.7 million MVPD subscribers. U-verse video is available to between 24.5 million

and 33 million TV homes in 142 markets across 22 states. Some small and medium-sized cable operators compete head-to-head against AT&T's U-verse service. The degree of competitive overlap of smaller cable operators with U-verse varies. However, where there is overlap, robust competition exists.

DIRECTV is the second-largest MVPD with approximately 20 million video subscribers in the U.S. It provides satellite MVPD service in all 50 states to nearly all 116 million TV homes. Small and medium-sized cable operators compete against DIRECTV whose service area either completely or nearly completely overlaps with all smaller operators. There is also robust competition between smaller cable operators and DIRECTV for video customers, notwithstanding the fact that most of these cable operators make available a "triple play" service and DIRECTV primarily offers only a standalone video service. DIRECTV and the other direct broadcast satellite provider ("DBS"), DISH Network, offer video service comparable to the video service of cable MVPDs at competitive prices, and existing double- and triple-play customers of smaller cable operators are willing to discontinue just their video service with a triple-play provider in order to switch to DIRECTV or DISH Network. Smaller cable operators report that offering the triple-play service is not attractive enough on its own to prevent DIRECTV and DISH from luring customers away. Price, content, and customer service still matter a lot in the MVPD market, and DIRECTV's offering of the NFL Sunday Ticket makes its service particularly attractive to a large subset of valuable customers. Even senior executives at DIRECTV seem to agree that video service offered as part of a triple play is a competitor, according to recent remarks made prior to AT&T's announced acquisition.¹

In the video programming industry, DIRECTV owns or manages three regional sports networks (RSNs): Root Sports Pittsburgh, Root Sports Rocky Mountain, and Root Sports Northwest. It also has interests in some national programming networks, including the MLB Network and the Game Show Network. Most small and medium-sized cable operators purchase some DIRECTV-affiliated programming. ACA is aware of at least 120 smaller cable operators carrying one or more Root Sports regional sports networks. Additionally, there are more than 600 small and medium-sized MVPDs that carry the Game Show Network through this networks' agreements with their buying group, the National Cable Television Cooperative ("NCTC"). Moreover, many individual smaller MVPDs have individual contracts with the MLB network. As a vertically integrated MVPD, DIRECTV has an incentive and ability to disadvantage its MVPD rivals in the sale of this programming by charging higher prices. The harm to its rivals, which includes hundreds of smaller operators currently carrying its programming, and ultimately to consumers, is particularly significant with regard to its RSNs – its most popular programming.

III. The Proposed Transaction Will Increase DIRECTV-Affiliated Programmers' Incentive to Charge Higher Prices to AT&T/DIRECTV's Rivals

ACA's members are concerned with the combination of AT&T's distribution assets with DIRECTV's distribution assets because it will incentivize DIRECTV-affiliated programmers to charge higher rates to the merged firm's rivals above and beyond existing incentives. This conclusion is based upon economic theory and evidence relied upon by the FCC in analyzing previous transactions involving MVPDs that have interests in programming. In these reviews, the FCC found that companies that own programming have an incentive to disadvantage their rivals in the sale of their affiliated programming *in proportion to their per-video-subscriber profits*.

¹ See "AT&T/DIRECTV: Regulatory and Business Takeaways from AT&T's Merger Application," Bernstein Research, at Exhibit 3 (June 19, 2014).

In other words, if the profit margin per video subscriber of a vertically integrated MVPD rises, so does its incentive to harm its rivals by either withholding its programming permanently or temporarily during negotiation impasses, or simply by forcing them to pay higher prices for this programming.²

AT&T and DIRECTV assert their proposed deal creates efficiencies, and to the extent this is true, many of these efficiencies will increase the profit per video subscriber of both U-verse and DIRECTV. As AT&T notes in its filing, the most significant cost savings from the proposed deal will come from the merged firm's ability to negotiate better programming deals. These cost savings will be fully realized as DIRECTV's existing programming contracts expire and are renegotiated. By adding AT&T's 5.7 million MVPD subscribers to DIRECTV's 20 million MVPD subscribers, the merged entity will become a "must have" distribution outlet for programmers, enabling it to command larger volume discounts than either firm is currently able to obtain. As AT&T notes, the deal also creates other costs savings, most of which appear to be realized in the near term.³ These cost savings in the aggregate will materially lower the cost of doing business for both the U-verse and DIRECTV service, and the U-verse and DIRECTV services will be more profitable per subscriber combined than as stand-alone entities.

Accordingly, the increased profitability per video subscriber that is realized by the proposed AT&T/DIRECTV merger will increase DIRECTV-affiliated programmers' incentive to charge higher prices to the merged firm's rivals, and the harm will be particularly significant with regard to its RSNs. If AT&T/DIRECTV acts on this incentive, the deal will harm DIRECTV's rivals in markets where its programming is available, and ultimately their customers as well.

IV. Regulators Should Adopt a Remedy to Eliminate the Ability of DIRECTV-Affiliated Programmers to Charge Higher Prices to AT&T/DIRECTV Rivals

While the Communications Act directly deals with vertically integrated cable operators, it does not have a provision preventing AT&T/DIRECTV from disadvantaging its rivals through the prices charged for affiliated programming. The existing program access rules prevent only cable operators and cable-affiliated programmers from engaging in unfair acts and practices, including imposing on other MVPDs discriminatory prices, terms, and conditions. These rules do not apply to programmers affiliated with DBS providers, like DIRECTV, or to non-cable MVPDs, like AT&T. Despite this fact, up until recently, rival MVPDs that reached an impasse in their negotiations with DIRECTV for its RSNs had a right to take DIRECTV to arbitration pursuant to a voluntary commitment with the FCC agreed to by DIRECTV when Liberty Media acquired DIRECTV. However, this condition, which was in place for more than six years, expired on February 27, 2014.

² For a complete discussion on the bargaining theory framework for analyzing the competitive effects of vertical integration, see "Vertical Mergers in the Video Programming and Distribution Industry: The Case of Comcast-NBCU," Professor William P. Rogerson (2012), available at: <http://faculty.wcas.northwestern.edu/~wpr603/Comcast-NBCU.pdf>.

³ According to AT&T's public interest statement, the proposed deal will allow AT&T and DIRECTV to consolidate broadcast centers, combine the distribution assets of AT&T's IP network and DIRECTV's satellite network, and to reduce costs associated with the operation of DIRECTV's and AT&T's super-hubs. It also will allow the merger of installation and service operations, and allow AT&T and DIRECTV to save money with respect to their customer call center operations, IT systems, and other general administrative and headquarters functions and services.

ACA believes regulators should impose a condition on AT&T/DIRECTV that prevents DIRECTV-affiliated programmers from disadvantaging the merged firm's rivals in the prices it charges. However, it would not be adequate to adopt similar arbitration conditions to those previously imposed on DIRECTV or the more recent version imposed on Comcast-NBCU. Those arbitration conditions, although well-intended, have a number of defects and problems limiting their effectiveness, particularly for small and medium-sized MVPDs. In particular, arbitration, even with one-way fee shifting, remains too expensive for individual small and medium-sized MVPDs to utilize. Smaller MVPDs also cannot precisely predict the results of an arbitrator's calculation of fair market value because they do not have precise information on the key factors that an arbitrator would likely use to make its determination, which is a problem exacerbated by the fact that much of this information is known by the programmer. Further, the manner in which a bargaining agent appointed by individual MVPDs could potentially avail itself of the arbitration conditions was poorly articulated and incompletely described in the FCC's Comcast-NBCU Order. ACA hopes to work closely with both the Subcommittee and the FCC throughout the year to explain the problems with arbitration conditions previously crafted by the agency and explore ways to fix them.

V. Congress and Policymakers Must Concurrently Address Regulatory Inconsistencies that Aggravate Existing Market Problems Facing MVPDs, Particularly Smaller MVPDs

Congress and regulators cannot limit their time and effort to looking just at deals like AT&T/DIRECTV and Comcast/TWC/Charter; they must provide enhanced oversight of the market as a whole, and update rules and regulations that work in the new market order. If all the pending MVPD deals are approved, the largest video distributors will grow even larger, creating an even greater disparity with the smallest providers with whom they compete. Moreover, the programming market is likely to respond to large video distributors getting larger by getting larger themselves, which will give these programmers even greater bargaining leverage over the smallest cable operators. Smaller cable operators need Congress to review the existing rules and regulations that govern the market to ensure that industrywide problems, which cannot effectively be dealt with through a merger review, are also addressed. This will ensure consumers that receive service from companies not growing larger through acquisition can continue to benefit from a competitive market. Given the mounting problems in the market even before the Comcast/TWC/Charter and AT&T/DIRECTV deals were announced, the public can't wait years for Congress to act. Action must be taken soon before smaller MVPDs exit the market, because once a smaller MVPD exits a market, particularly in rural areas, it is unlikely that Wall Street or Main Street will fund its return, or that government programs will help.

Although not all the marketplace problems can be easily addressed, ACA specifically urges Congress and the FCC to take action to better ensure that smaller MVPDs are not unreasonably disadvantaged compared to other industry participants, and that rules applied to smaller MVPDs are applied in a competitively and technologically neutral manner. The following are some examples where oversight and action by Congress or the FCC are appropriate at the same time that regulators decide whether to approve the AT&T/DIRECTV and Comcast/TWC/Charter deals.

Promoting Competition by Ensuring that Price Discrimination in Programming Contracts is Not Harming Consumers and Competition

For the last decade, small and medium-sized operators have been outspoken about the rising cost of programming, particularly sports programming, and the increasing demands of

programmers to require their customers to receive and pay for unwanted programming. In the early years, smaller MVPDs were alone in their concerns, but now these concerns are shared by larger MVPDs as well. For most MVPDs, the single largest cost of providing video service is programming cost, and the relative cost of programming for smaller MVPDs is significantly higher than for larger MVPDs because of the discriminatory pricing practices of the large programmers. The spread between the largest and smallest is commonly thought to average about 30%. As ACA has noted in the past, this price discrimination is not justified based on the cost of delivering the service to the distributor. Given that most MVPDs have at least two large national DBS competitors, small and medium-sized MVPDs are often at a substantial competitive disadvantage against their larger competitors, who typically have many more subscribers, often tens of millions of more subscribers, because the most significant cost of providing a comparable video service is so very different. This problem is most pronounced for recent entrants in the market.

Given these marketplace realities, small and medium-sized cable operators are not surprised by AT&T's interest in acquiring DIRECTV. With nearly 6 million subscribers, AT&T finds itself in competition against Time Warner Cable with 11 million subscribers, DISH Network with 14 million subscribers, DIRECTV with 20 million subscribers, and Comcast today with 22 million subscribers. After trying to compete in the MVPD market for years, AT&T learned that it is hard when its programming costs are so much higher than its competitors – allegedly at least 20% higher than DIRECTV's – and likely even greater compared to Comcast. They also understand their current competitive standing would get even worse if regulators approve the Comcast/TWC/Charter deals. With respect to addressing their programming cost issue, this deal solves that problem.

While AT&T can buy its way out of its programming cost problems by purchasing a large MVPD like DIRECTV, small and medium-sized operators, who do not have the deep pockets of AT&T, are not so fortunate. They are increasingly struggling to stay profitable, no less survive, and consumers in their service territory are paying the price. Critics of the AT&T/DIRECTV merger have raised concerns about the decrease in the number of competitors for video service from four to three in AT&T U-verse territories. In many rural areas where there are only three providers of video service, rising programming prices are now driving some smaller MVPDs to exit the market altogether, leaving consumers with only two providers, a marketplace that is far less competitive than what consumers in AT&T U-verse territories will face. Unfortunately, decreasing levels of competition in these areas, which occur on a slow but steady basis, rarely generate the same levels of concerns from policymakers in Washington, but they should because they are often leading indicators of problems soon to face the market as whole.

ACA recently reported to the FCC that between 2008 and 2013, small and medium-sized cable operators closed a total of 1,078 small and rural cable systems, the vast majority of which reflect systems that have ceased providing video service in their communities. At the time of their closing, these systems served a total of approximately 50,000 subscribers. After these systems closed, consumers in these rural areas saw a reduction in competition as their only choices for video service became DIRECTV and DISH Network. Given the rise in programming costs, we are likely to see even more system closings in the coming years. Moreover, we're also likely to see more small cable systems controlling costs by dropping programming, particularly independent programming.

Unless Congress or the FCC can find a way to put small operators on a fairer competitive playing field with their larger rivals, particularly with regard to the cost of programming, the loss of those operators and the unique competitive alternative they provide

will increase and start expanding into more populous areas. In particular, Congress and the FCC should examine and find ways to address programmers' discriminatory pricing practices, which are some of the biggest threats facing smaller operators and will grow more troublesome if the Comcast/TWC/Charter and AT&T/DIRECTV deals are approved.

Promoting Competition by Ensuring Buying Groups like the NCTC Have Access to the Program Access Rules as Congress Intended

Congress sought to ensure that smaller operators were protected from discriminatory and unfair behavior by cable operators and cable-affiliated programmers by extending "program access" protections to their buying groups. However, the regulations adopted by the FCC, particularly its definition of a "buying group," prevent the nation's largest programming buying group, the NCTC, from availing itself of the protections Congress intended. This means that more than 900 MVPDs, who obtain most of their national programming through this organization, are effectively denied the protection of the program access rules. Moreover, it puts smaller MVPDs at a competitive disadvantage with larger MVPDs who can avail themselves of the program access rules. For nearly two years, the FCC has been considering the adoption of new rules that would allow a buying group, like the NCTC, to file program access complaints and also contain safeguards to prevent programmers from evading the protections of the rules. It is vital that the FCC act now by updating its definition of a buying group, making clear programmers must treat buying groups comparably to other MVPDs, and not arbitrarily excluding certain buying group members from joining a master agreement signed by the buying group.

Promoting Competition by Ensuring FCC Regulatory Fees tied to MVPD-related work by the FCC's Media Bureau are Assessed on all MVPDs, including DBS Companies.

Congress requires the FCC to recover the costs of its activities from entities subject to its regulatory authority. Generally speaking, industry participants that receive direct benefits of a core bureau of the FCC are assessed fees that reflect those benefits. However, this is not the case with regard to the MVPD industry where the costs of the Media Bureau's MVPD-related activities are not assessed in a competitively neutral manner. Despite the extensive regulatory, policy, rulemaking and enforcement activities that Media Bureau employees engage in that concern and benefit all MVPDs, including DBS operators, DBS MVPDs, like DIRECTV, currently pay no (zero) fees to cover these costs. In contrast, cable operators pay a fee of \$1.00 per subscriber.

Last year, the FCC recognized that IPTV providers like AT&T benefited from Media Bureau MVPD regulatory activities, and should therefore be included in the same fee category as cable operators. This brought regulatory fee parity between cable and non-cable MVPDs. The FCC is still considering whether DBS operators should also pay similar regulatory fees. According to the FCC's most recent regulatory fee rulemaking notice, the per-subscriber regulatory fees for cable operators and IPTV providers would drop from \$1.00 to \$0.68 if DBS were included in the relevant fee category. The notice asks whether it should expand this fee category to include DBS providers and whether it should change the name of the category to "MVPD" or "subscription television fees" or another appropriate name that would treat MVPD market participants more equally than they are today.

ACA strongly supports creation of such a fee category to include DBS, as has AT&T. The fact that DBS providers do not shoulder their fair share of the fee burden is more than simply a matter of equity. This disparity in fee assessment can have market-distorting effects.

As noted above, because DBS operators do not pay fees to cover the expenses of the FCC's Media Bureau regarding MVPD-related work, these costs are shifted entirely onto cable operators and IPTV providers that do pay the fees. Moreover, because cable operators typically pass through regulatory fees to customers, the DBS exemption has the effect of raising the cost of cable service for consumers. This is especially unfair to smaller operators serving smaller and rural markets, who are the least able to bear regulatory fee burdens and for whom the two DBS operators are the primary competition. The time has come to ensure that rules governing small and medium-sized MVPDs are applied to all MVPDs in a technologically and competitively neutral manner, and Congress or the FCC should address this problem immediately.

VI. Conclusion

As the consolidation wave in the MVPD and video programming industry continues, federal decision-makers must ensure that consumers and competition are protected. This means taking seriously their duty to review pending transactions under the antitrust laws and public interest standards and adopting appropriate remedies to address identified harms, specifically those raised in this testimony. It also means taking action on existing market problems threatening the important competitive choice that small and medium-sized operators provide. The AT&T/DIRECTV transaction and others highlight these problems. The choices that Congress makes to deal with these issues are profound. ACA looks forward to working closely with both Congress and the agencies in their review of the AT&T/DIRECTV deal, and in crafting rules that make the broader industry fairer to the independent cable community.

PREPARED STATEMENT OF CHAIRMAN PATRICK J. LEAHY

**Statement of Senator Patrick Leahy (D-Vt.),
Chairman, Senate Judiciary Committee,
Hearing on "The AT&T/DIRECTV Merger: The Impact on Competition and Consumers
in the Video Market and Beyond"
June 24, 2014**

Today, the Antitrust Subcommittee holds a hearing to examine another significant transaction in the telecommunications industry. The pending merger between AT&T and DirecTV will combine one of the largest wireless providers in the country with the nation's second largest pay-television provider. A merger of this size will impact millions of consumers, including many in rural areas like Vermont. I appreciate that Senator Klobuchar and Senator Lee are continuing the bipartisan tradition of conducting a careful and thoughtful examination of major mergers.

The satellite industry plays a vital role for many rural consumers who would not otherwise be able to receive television service. The critical function of DirecTV in states like Vermont is why I have worked in the Senate to foster a healthy and competitive satellite industry. I hope that if this transaction is allowed to go forward, the merged company will maintain its commitment to rural areas and viewers.

This transaction differs from the proposed Comcast-Time Warner Cable merger because AT&T and DirecTV directly compete against each other with video products in 25 percent of the country. The potential for consumers to lose a competitor in the overlapping territory means that this deal warrants close examination by the antitrust authorities. At a time when too many consumers lack meaningful choice in television providers, a transaction that results in the elimination of a competitor should be scrutinized.

AT&T and DirecTV claim that the new company formed by this transaction will have the scale necessary to drive down content costs. I appreciate the appeal of lower costs to the company and its shareholders, but it is unclear whether these potentially significant savings will be passed along to consumers. I hope that today's witnesses will address whether that will be the case.

It is also important to consider the impact this deal will have on broadband deployment. AT&T has stated that it will use the cost savings from this transaction to build out a fixed wireless network to approximately 13 million customer locations, predominately in rural areas. I appreciate AT&T's acknowledgment that there is more work to be done to reach unserved or underserved rural areas. Private sector investment in this area could go a long way in bringing universal broadband service to all Americans. I look forward to hearing more about this plan and the impact it will have on rural areas.

There is little doubt that the Department of Justice and the Federal Communications Commission have their hands full this summer reviewing two major telecommunications transactions. I nonetheless expect that each will conduct a thorough and meaningful review. The Judiciary Committee continues to play an important, complementary role to the merger review process by asking the questions that matter to consumers. I thank Senator Klobuchar and Senator Lee for holding this hearing today and I look forward to hearing from the witnesses.

#

QUESTIONS SUBMITTED TO RANDALL STEPHENSON BY SENATOR KLOBUCHAR

Senator KlobucharQuestions following the AT&T/DIRECTV HearingFor Randall Stephenson

1. AT&T's U-verse video competes with DIRECTV in about 25 percent of the country covering about 30 million homes. AT&T also competes with the local cable company and DISH Network. If AT&T acquires DIRECTV, these consumers will go from having four competitors down to three. At the hearing you focused on the 75 percent of the country that will not lose a competitor. However, 30 million homes is not an insignificant number. For those consumers, how is this merger different than the merger between AT&T and T-Mobile, which also eliminated a direct competitor, that was blocked by the DOJ and FCC in 2011?
2. As part of your merger announcement, AT&T committed to provide standalone broadband service and to maintain national pricing for DIRECTV for three years. After three years expire, what should consumers expect? Will you have to maintain stand-alone broadband and television services at reasonable market-based prices?
3. Consumers outside of AT&T's footprint currently have an alternative to cable bundles of phone, video and broadband through DIRECTV's "synthetic bundles" with phone and broadband companies such as Verizon and CenturyLink. AT&T's FCC public interest filing said that it expects to continue offering these "synthetic bundles" between DIRECTV and other broadband providers. However, with AT&T expanding its broadband footprint with fixed wireless loop technology, it may be in AT&T's interest to end those agreements in the future and limit DIRECTV consumers' choice of broadband and phone bundles to AT&T's. In the alternative, AT&T could be incentivized to limit competition to its own bundle by offering DIRECTV to a bundling partner at an uneconomical price that prohibits them from competing against AT&T. What incentives will you have to continue offering DIRECTV synthetic bundles with other wireline broadband companies in areas where AT&T provides fixed wireless local loop broadband? Will you commit to offering stand-alone DIRECTV video products to bundling partners at reasonable and non-discriminatory prices?
4. AT&T claims that it needs this merger so that it can justify the cost of its proposed broadband expansion. AT&T is committing to upgrade or build out fiber to 2 million households and another 13 million would get fixed wireless local loop technology. At the hearing and in your testimony, you cited \$1.6 billion in cost savings annually after three years.
 - a. How much do you estimate the broadband expansion will cost? And what percentage of AT&T's cost savings will be devoted to the broadband build out and how much will be devoted to putting downward pressure on cable prices, presumably by lowering consumer prices?
 - b. In your public interest filing, you say that fixed wireless local loop service is "relatively untested technology" and "its success in the marketplace is thus unproven." What happens if this deployment is not successful?

- c. Are you planning to use any Connect America funds for the 15 million home build out of your network that you are promising with this merger?
5. We recently had a hearing on the IP transition in the Commerce Committee where we discussed the evolving IP-based communications systems and what that means for regulations, and particularly public safety. AT&T has been a significant player in the FCC's decision to allow for IP trials to test the impacts of changes in communications technology on consumers and on the need for regulations to protect them. Is it correct that you will be testing the same wireless IP "cantennas" that you are highlighting in this merger as a new broadband option for rural consumers? How would you address the concerns that this wireless broadband connection is not adequate to provide quality, reliable connections for consumers?
6. **(FOR COMMUNITY ALLIANCE FOR MEDIA – represent PEG channels)**
Concerns have been raised over the years about AT&T's implementation of its public, educational and government access ("PEG") channel requirements. As I understand it there is one channel with a drop down menu that serves multiple jurisdictions. Is AT&T making any effort to improve this? As part of your upgrades and adding more value, will you work to improve your U-verse customers' access to PEG channels?

QUESTIONS SUBMITTED TO MICHAEL WHITE BY SENATOR KLOBUCHAR

Senator KlobucharQuestions following the AT&T/DIRECTV HearingFor Mr. White

1. Your testimony implied that the only way to offer customers a single bill is by merging with AT&T. However, AT&T's website indicates that it is possible for customers to receive a single bill with an AT&T/DIRECTV synthetic bundle if they the bundle from AT&T.¹ In fact, Michael Katz, an economist who contributed to AT&T's public interest filing with the FCC, specifically notes that a \$5 discount is given to customers who sign up through AT&T to receive only one bill. Why is this merger required to give this particular convenience to customers? Why is DIRECTV not offering a single-bill option today? Given that AT&T is already able to offer one bill to customers, should this be considered by the subcommittee and the antitrust agencies as a merger specific efficiency?
2. How does this merger fix the problem of "double marginalization?" According to you and Mr. Stephenson, if the merger is permitted, only one company needs to make a profit on an integrated bundle, rather than two with a synthetic bundle. However, the combined AT&T/DIRECTV would only have one other bundle to compete with in most markets. Will such a duopoly result in the cost savings from converting a synthetic bundle into a regular bundle being passed onto consumers?

¹ <http://www.att.com/shop/bundles/directv-internet-phone.html> "Why Bundle? . . . Make payments on one bill."

QUESTIONS SUBMITTED TO MATTHEW F. WOOD BY SENATOR KLOBUCHAR

Senator Klobuchar

Questions following the AT&T/DIRECTV Hearing

For Mr. Wood

1. Should consumers be wary of the fixed wireless local loop offering that AT&T is proposing to offer to 13 million rural customers? Are these fixed wireless IP offerings more expensive? Will this be a competitive option for rural consumers?
2. This merger is primarily about video service, but mobile phone service is relevant as well because this merger involves one of the top two wireless carriers and we are beginning to see wireless, broadband and video markets converge. AT&T will gain significant relationships by acquiring its DIRECTV's 20 million subscribers. What's the significance of this deal to the wireless industry and how could it impact wireless competition?

QUESTIONS SUBMITTED TO LARRY DOWNES BY SENATOR KLOBUCHAR

Senator Klobuchar

Questions following the AT&T/DIRECTV Hearing

For Mr. Downes

1. You have studied disruptive forces in the telecomm industry. In your testimony, you talk about how Google, Amazon, Apple and others have experimented with new technologies and new business models. That's exactly the kind of innovation we like to see. Absent this merger, do you think AT&T and DIRECTV would have the incentive to react to the changes and challenges in the market place with their own experimental business models and disruptive forces?
2. This merger is primarily about video service, but mobile phone service is relevant here as well because this merger involves one of the top two wireless carriers and we are beginning to see wireless, broadband and video markets start to converge. AT&T will gain significant relationships by acquiring its DIRECTV's 20 million subscribers. Do you think this will enhance competition in the wireless market? How would NFL Sunday ticket impact or disrupt the wireless market if AT&T is able to make a wireless deal with the NFL?

QUESTIONS SUBMITTED TO ROSS J. LIEBERMAN BY SENATOR KLOBUCHAR

Senator Klobuchar

Questions following the AT&T/DIRECTV Hearing

For Mr. Lieberman

1. AT&T and DIRECTV claim that this merger is necessary because consumers want bundled video and broadband service, rather than DIRECTV stand-alone video or synthetic bundles with broadband. They say that the merger won't reduce competition because AT&T and DIRECTV don't compete for bundled services. Do you agree? What do your members' experiences show with regard to consumer preference for bundles? Do they see consumers unbundling their video and other services to use a stand-alone video from satellite competitors?

QUESTIONS SUBMITTED TO RANDALL STEPHENSON BY SENATOR FRANKEN

Senate Judiciary Committee, Antitrust Subcommittee Hearing
“The AT&T/DIRECTV Merger:
The Impact on Competition and Consumers in the Video Market and Beyond”
Questions for the Record Submitted by Senator Al Franken for Randall Stephenson

1. During the hearing, you said that you did not know whether AT&T has spent money lobbying for laws that restrict municipal broadband. Now that you have had an opportunity to consult appropriate documents and personnel, please answer the following questions: Has AT&T lobbied to restrict municipal broadband development? If so, please describe such efforts, including the amount of money spent on such efforts, the proposals for or against which AT&T has lobbied, and the states or locales in which such lobbying has taken place.
2. During the hearing, you stated: “I have personally advocated that where we are investing or others are investing private capital that we shouldn’t be required to compete against government taxpayer money.” According to the Institute for Local Self-Reliance, many municipal networks are financed by bonds to private investors that are repaid with revenues from the network. Do you believe municipal networks that are financed this way have a right to compete in an open marketplace?
3. How much federal taxpayer money has AT&T requested from the Connect America Fund to subsidize its broadband network?
4. During the hearing you stated: “[Unserved areas] seem like a logical place for government to step in and provide a solution.” However, many restrictions on municipal broadband apply equally to all parts of a state, including unserved areas. Do you believe unserved areas should be exempt from such restrictive laws?
5. AT&T has a history of blocking applications that compete with its own voice and messaging services, including Skype, Google Voice, and Apple’s FaceTime. The FaceTime blocking ended once the FCC began investigating whether your company was violating the Open Internet Order. Do you believe these incidents contradict AT&T’s stated commitment to net neutrality? Please explain why or why not.
6. Do you believe the Open Internet Order allows for paid prioritization?
7. Sprint is reportedly nearing an agreement to acquire T-Mobile. Sprint and its parent company, Softbank, say they need a merger to compete with AT&T and Verizon in the wireless market. What do you make of this argument?

RESPONSES OF LARRY DOWNES TO QUESTIONS SUBMITTED
BY SENATOR KLOBUCHAR



Responses to Questions for the Record of

Larry Downes

Project Director, Georgetown Center for Business and Public Policy

The Evolution of Regulation and Innovation Project

U.S. Senate Committee on the Judiciary

Subcommittee on Antitrust, Competition Policy and Consumer Rights

"The AT&T/DIRECTV Merger: The Impact on Competition and Consumers in the Video Market and Beyond"

July 14, 2014

Senator Amy Klobuchar

1. You have studied disruptive forces in the telecomm industry. In your testimony, you talk about how Google, Amazon, Apple and others have experimented with new technologies and new business models. That's exactly the kind of innovation we like to see. Absent this merger, do you think AT&T and DIRECTV would have the incentive to react to the changes and challenges in the market place with their own experimental business models and disruptive forces?

There is no doubt that AT&T and DIRECTV, along with every other incumbent enterprise in the video market, already have powerful incentives to respond to the disruptive challenges presented by an explosion of largely unregulated new businesses offering competing and complementary products and services using the Internet.

The question, however, is whether they have the ability to respond with their own experiments and disruptions. Absent the proposed transaction, I do not believe that either company can be successful in the long-term as the video market continues its rapid reconfiguration.

The challenges are both regulatory and technological. As noted in my written testimony, both companies must innovate from within the constraints of a dense thicket of MVPD video regulations that have built up over the last few decades in response to earlier disruptive technologies, including once-experimental technologies for distributing video content over satellite, microwave, coaxial cable, copper, cellular and fiber-optic cable.

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To protect important public interests including localism and the preservation of traditional advertising-supported over-the-air broadcast television, Congress, the FCC and the courts have cobbled together a series of compromises that, whatever their continuing value, severely limit the flexibility and adaptability of MVPDs in the face of substantial disruptive innovation in the over-the-top market.

The complex interactions of must-carry, retransmission consent, network nonduplication, the compulsory license and other limits, and their unintended impact on private negotiations between content providers and MVPDs, for example, several constrain the ability of incumbent video providers to innovate. They cannot easily offer more personalized packages of channels, or experiment with new kinds of payment options including ad-supported, on-demand, subscription, “freemium” and others.

Such regulatory constraints are almost entirely absent in the OTT market, on the other hand, which is why we see such remarkable experimentation going on, not only with traditional content but with new forms of user-created programming. As a result, a vast new world of video products and services has opened up, built on increasingly better and cheaper video production equipment, cloud computing, bootstrapped funding sites including Kickstarter, and new aggregators such as YouTube and Vimeo.

On YouTube alone, users upload 100 hours of original programming every minute, and not all of it about cats. Broadcaster and unaffiliated domain-specific sites, including VSauce (science), Machinima (gaming), and Funny or Die (comedy), are among the most visited sites on the Internet. Popular channels on these sites support tens of millions of subscribers, and maintain a level of interactivity unheard of in the stagnant world of traditional media. Producers ask the viewers what shows they want to see next, and promptly produce them. Fans share the programming they like on large-scale social networks including Twitter, Reddit, and Facebook.

Beyond these regulatory constraints, technical challenges weigh particularly hard on DIRECTV. Simply put, as I indicated at the hearing, the physics of satellite transmissions have made it extremely difficult for DIRECTV and other satellite-based MVPDs to offer native Internet access to their customers, or, indeed, any kind of two-way interaction between the MVPD and its customers.

While DIRECTV has tried with limited success to meet its customers’ increasing demands for bundled video, voice and Internet through partnerships with other companies, this is at best a stop-gap measure. To truly compete with OTT providers, incumbent video providers need the technical ability not just to offer Internet access to their customers but to integrate video with other information products and services, allowing the kind of interaction with the content and its producers that consumers are already taking for granted, particularly in the OTT market.

DIRECTV doesn’t simply require better integration of Internet access, in other words. It needs the ability to offer native Internet content and interactivity as its core product.

The merger, I believe, would help both companies close their regulatory and technology gaps, creating a more formidable competitor both to other MVPDs as well as to emerging OTT providers. With DIRECTV’s customer base, U-Verse would have considerably more bargaining leverage with increasingly powerful content providers such as Disney, CBS, and FOX. With U-Verse’s state-of-the-art Internet architecture, DIRECTV would be able to offer its customers not only better-integrated Internet access but native Internet-based interaction.

Without the merger, I don’t see how either company can effectively respond to these challenges.

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As I explained in **The Washington Post**¹ following the hearing:

For video consumers, as for the residents of Napoleonic Paris and London in Charles Dickens's classic novel, it is the best of times and the worst of times.

Those who rely on traditional broadcast, cable and satellite television are living in a world where fewer content providers own and control the bulk of the programming, using their leverage to force operators to take ever-larger bundles of channels at higher prices that are passed on to consumers. As much as 60 percent of the average cable bill, for example, goes directly to mega-producers such as Disney, Fox and CBS. The average cable viewer pays nearly \$6 just for ESPN, whether they watch it or not.

Trapped by bloated channel packages and limited flexibility, consumers are voting with their feet. Pay TV networks have lost millions of viewers in the last few years, bringing into serious question how much longer its mature model of content aggregation and distribution can last.

Where are consumers going? The Internet, of course. And why not? For those who have cut the cord (or, for a growing segment of younger consumers, never had a cord in the first place), the world is much brighter and the focus far sharper. Much of the network programming they want is available on demand from the programmers' own Web sites, or from virtual bundlers including Hulu, Amazon, Apple and Netflix, either for free or at a fraction of the cost of a standard cable subscription, offered through customizable a la carte, subscription, and ad-supported options.

But beyond content traditionally available from cable, satellite or broadcast, a vast new world of video has opened up, built on increasingly better and cheaper video production equipment, cloud computing, bootstrapped funding sites including Kickstarter, and new aggregators such as YouTube and Vimeo. On YouTube alone, users upload 100 hours of original programming every minute, and not all of it about cats.

Popular channels on these sites support tens of millions of subscribers, and maintain a level of interactivity unheard of in the stagnant world of traditional media. Producers ask the viewers what shows they want to see next, and promptly produce them. Fans share the programming they like on large-scale social networks including Twitter, Reddit, and Facebook.

[...]

My testimony focused on disruption in the video marketplace. I noted that AT&T's U-Verse video service is a loss leader the company offers largely to supplement its broadband Internet business (the company has fewer than 150,000 customers who subscribe only to video), while DirecTV offers no native Internet service, and is unlikely to given the limits of satellite technology. AT&T needs DirecTV's customer base to improve its bargaining position with increasingly powerful

¹ Larry Downes, *A Tale of Two Video Markets: Welcome to the Post-Aereo World*, THE WASHINGTON POST, July 2, 2014, available at <http://www.washingtonpost.com/blogs/innovations/wp/2014/07/02/a-tale-of-two-video-markets-welcome-to-the-post-aereo-world/>.

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content providers, and DirecTV needs U-Verse's broadband network to remain competitive with cable and other networks.

Both companies need each other, more to the point, to offer customers the kind of flexibility available today from largely unregulated Internet video services. Cord-cutters are demanding the ability to watch whatever content they want wherever they are and whatever device they happen to have handy. Together, the two companies could do that. Separately, they cannot.

As I also noted in the **Post** article, in the long-term even this transaction will not overcome the unintended constraints on regulated MVPDs imposed by the existing legal regime. This Subcommittee, of course, has held numerous hearings on the problem and its members have taken the lead in proposing reforms large and small to address the imbalances between content providers and MVPDs and between MVPDs and fast-rising unregulated OTT competitors.

While I believe the proposed transaction will give a new lease on life to both U-Verse and DIRECTV, I want to underscore the continued need for regulatory reform to preserve competition from and among the traditional video industry.

2. **This merger is primarily about video service, but mobile phone service is relevant here as well because this merger involves one of the top two wireless carriers and we are beginning to see wireless, broadband and video markets start to converge. AT&T will gain significant relationships by acquiring its DIRECTV's 20 million subscribers. Do you think this will enhance competition in the wireless market? How would NFL Sunday ticket impact or disrupt the wireless market if AT&T is able to make a wireless deal with the NFL?**

I am unable to comment on the specific impact of NFL Sunday Ticket on the existing or future dynamics of the video market. Both existing licenses and pending negotiations are not public, and I have no access to the specifics of existing or rumored deals between the respective parties.

I do, however, see significant positive impacts on competition through synergies between AT&T's mobile and video services. As you note, convergence on native Internet products and services is not a Big Bang Disruption limited to the video market. More and more, voice, video and data services are converging on Internet standards, leading consumers to demand full integration and the ability to mix and match services old and new.

In the mobile market, the unprecedented adoption by consumers of smartphones and tablets since 2009 has been largely driven by an explosion in video-based services that consumers can't seem to get enough of. The vast bulk of mobile traffic is now video traffic, as consumers engage with old and new forms of programming on their mobile devices. And they fully expect all content to be available on all devices and, indeed, expect that content begun on one device and network can be continued on all the others, depending on where they are and what they are doing.

Competition in the mobile market today is driven by several factors, including price, device and operating system availability, proprietary and open app stores, network coverage, speed, and reliability.

Integration between mobile networks and other services, however, is fast emerging as a competitive imperative for network operators. Soon, emerging services including home automation, health

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monitoring and tele-health, home security, the smart grid and other utility integration, remote education and other new technologies will increase the pressure on mobile network operators, as well as wired providers, to offer fully-connected platforms.

Following the transaction, the combined AT&T/DIRECTV will need to expend considerable financial and technical resources to complete the integration of their video and Internet services. In the short term, therefore, I do not anticipate significant impact on competition in the mobile market from this transaction. Once that integration is completed, however, the combined company may well see competitive advantage in further integrating its video offerings to customers of AT&T's mobile network.

Given insatiable consumer demand for such services, it is reasonable to assume that if the company does proceed in this manner, competitive pressure will build on other mobile network operators to accelerate their own integration of voice, video, and data services on multiple technologies onto a single Internet-based platform that is transparent to consumers. In that regard, the transaction could significantly encourage competition in the mobile market.

As with the traditional MVPD market, as noted above, the combined consumer base of the two companies will likewise help to better balance negotiations between AT&T/DIRECTV and dominant content providers in negotiations for content access over mobile devices. That too could in turn encourage innovative competitive responses from other mobile network operators.

RESPONSES OF ROSS J. LIEBERMAN TO QUESTIONS SUBMITTED
BY SENATOR KLOBUCHAR

Senator Klobuchar

Questions following the AT&T/DIRECTV Hearing

For Mr. Lieberman

1. AT&T and DIRECTV claim that this merger is necessary because consumers want bundled video and broadband service, rather than DIRECTV stand-alone video or synthetic bundles with broadband. They say that the merger won't reduce competition because AT&T and DIRECTV don't compete for bundled services. Do you agree? What do your members' experiences show with regard to consumer preference for bundles? Do they see consumers unbundling their video and other services to use a stand-alone video from satellite competitors?

It is true there is an increasing number of households subscribing to a bundled video and broadband service, but it's also true that many millions of households still subscribe to DIRECTV and DISH Network as a stand-alone video service that is not part of any synthetic bundle with another telecommunications provider. But for DIRECTV and DISH Network, these households would receive their video service from other providers. Competition for these households exists, and will exist for many years into the future. With regard to the merger, in 25 percent of the country, covering about 30 million homes, AT&T U-verse is available as an alternative to DIRECTV. In these areas, AT&T's acquisition of DIRECTV will reduce the competition that exists between DIRECTV's standalone video service and the AT&T U-verse product to the detriment of consumers.

Small and medium-sized cable operators disagree with AT&T's assertion that triple play providers are not in competition with DIRECTV. Notwithstanding the fact that most of these smaller cable operators make available a "triple play" service, DIRECTV and DISH Network offer a video service that is comparable to the video service of cable operators at competitive prices, and existing double- and triple-play customers of smaller cable operators are willing to discontinue just their video service in order to switch to DIRECTV or DISH Network. Smaller cable operators report that providing a triple-play service is not attractive enough on its own to prevent DIRECTV and DISH from enticing customers away. Price, content, and customer service continues to make a big difference in the pay television market, and DIRECTV's offering of the NFL Sunday Ticket makes its service particularly attractive to a significant subset of valuable customers.

RESPONSES OF RANDALL STEPHENSON TO QUESTIONS SUBMITTED
BY SENATOR KLOBUCHAR

Senate Judiciary Committee, Antitrust Subcommittee Hearing
“The AT&T/DIRECTV Merger:
The Impact on Competition and Consumers in the Video Market and Beyond”
Questions for the Record Submitted by Chairman Amy Klobuchar for Randall Stephenson

1. AT&T’s U-verse video competes with DIRECTV in about 25 percent of the country covering about 30 million homes. AT&T also competes with the local cable company and DISH Network. If AT&T acquires DIRECTV, these consumers will go from having four competitors down to three. At the hearing you focused on the 75 percent of the country that will not lose a competitor. However, 30 million homes is not an insignificant number. For those consumers, how is this merger different than the merger between AT&T and T-Mobile, which also eliminated a direct competitor, that was blocked by the DOJ and FCC in 2011?

This transaction is different because it combines complementary assets for the benefit of consumers. DIRECTV is a profitable standalone video provider with a nationwide footprint. AT&T, on the other hand, is first and foremost a broadband company, with extensive fixed broadband and wireless networks. AT&T has less than 140,000 stand-alone video subscribers sprinkled throughout its limited video footprint, and its video service is unprofitable. Thus, even the limited overlap of potential customer bases between the companies overstates the level of competition between them. The true competitive significance of the transaction is found in the creation of a stronger competitor against cable, which is the dominant provider of video and broadband, and in particular the creation of a company that can offer an improved broadband/video bundle to a much greater number of consumers.

2. As part of your merger announcement, AT&T committed to provide standalone broadband service and to maintain national pricing for DIRECTV for three years. After three years expires, what should consumers expect? Will you have to maintain standalone broadband and television services at reasonable market-based prices?

After three years, consumers can expect just what they have always gotten from us – innovative products and services that meet their evolving needs and preferences. Today, consumers demand competitive, efficient bundles of video and broadband services, and we expect that demand to swell even more in the years to come. However, as long as customers desire standalone options in addition to bundles, AT&T will continue to give consumers that choice by offering standalone services at reasonable, market-based prices. AT&T operates in a highly competitive market, and we look forward to continuing to giving customers what they want.

3. Consumers outside of AT&T’s footprint currently have an alternative to cable bundles of phone, video and broadband through DIRECTV’s “synthetic bundles” with phone and broadband companies such as Verizon and CenturyLink. AT&T’s FCC public interest filing said that it expects to continue offering these “synthetic bundles” between DIRECTV and other broadband providers. However, with AT&T expanding its broadband footprint with fixed wireless loop technology, it may be in AT&T’s interest to end those agreements in the future and limit DIRECTV consumers’ choice of broadband and phone bundles to AT&T’s. In the alternative, AT&T could be

incentivized to limit competition to its own bundle by offering DIRECTV to a bundling partner at an uneconomical price that prohibits them from competing against AT&T. What incentives will you have to continue offering DIRECTV synthetic bundles with other wireline broadband companies in areas where AT&T provides fixed wireless local loop broadband? Will you commit to offering stand-alone DIRECTV video products to bundling partners at reasonable and non-discriminatory prices?

As noted in the question, we plan to continue to offer these synthetic bundles to consumers, and indeed, these synthetic bundle offerings will be an important part of our sales efforts wherever we do not offer our own wireline broadband service. In those areas where we do offer wireline broadband service, our focus will be on offering our integrated bundle of video and broadband, which is a product that we believe consumers will find to be attractive. Additionally, as our economic analysis makes clear, our integrated bundle will further benefit consumers by putting downward pressure on cable prices. In the rest of the country, we will continue to rely on broadband partners such as Verizon and CenturyLink to meet the demand for video/broadband bundles. These partners will be an important part of our business.

4. AT&T claims that it needs this merger so that it can justify the cost of its proposed broadband expansion. AT&T is committing to upgrade or build out fiber to 2 million households and another 13 million would get fixed wireless local loop technology. At the hearing and in your testimony, you cited \$1.6 billion in cost savings annually after three years.

a. How much do you estimate the broadband expansion will cost? And what percentage of AT&T's cost savings will be devoted to the broadband build out and how much will be devoted to putting downward pressure on cable prices, presumably by lowering consumer prices?

Our broadband commitment is a four-year commitment, beginning upon close of the transaction. Between now and close and, indeed, during the build itself, we will continually refine our cost estimates of the effort. The cost estimates related to this deployment are proprietary. At this time, however, we estimate that the costs of the expansion to the additional 15 million potential customer locations will involve a multi-billion dollar investment – an investment made possible by the economics associated with the addition of DIRECTV to our company.

Our business planning does not allocate or earmark the potential cost savings arising from reductions in programming costs to particular infrastructure projects or to particular uses of the funds generally. Instead, the anticipated reductions in what we would have otherwise spent on programming are the underpinnings of our ability to enhance our infrastructure development. The transaction transforms what had been an unprofitable video business into one that generates positive margins; as a result, it improves the business case for developing infrastructure. This expansion allows us to increase both our video customer base and our broadband customer base, which then further improves the economics of both offerings. We will have greater flexibility and ability to invest and improve our integrated video offering and the customer experience, including by ensuring that our pricing of those services remains competitive in the market and provides a superior offering to consumers.

- b. In your public interest filing, you say that fixed wireless local loop service is “relatively untested technology” and “its success in the marketplace is thus unproven.” What happens if this deployment is not successful?**

Although there are uncertainties related to particular aspects of the technology and customer response to the fixed wireless local loop service, this transaction favorably alters the economics for deploying the service. By being able to integrate our broadband offering effectively with a profitable video offering, AT&T anticipates that consumers will see significant improvements in the quality and value of the offering by the combined company and more customers will purchase the offering and that a higher percentage of them will continue to find it to be a compelling value. In addition, the projected costs associated with installing fixed wireless local loop equipment at a customer’s home change dramatically when you are also installing or servicing a DIRECTV satellite dish. As a result, the AT&T/DIRECTV transaction gave AT&T the confidence to deploy the service and is committed to the investment it will require. While questions may remain, as they do with any new service, regarding the precise level of customer interest and how customers will react over time, those uncertainties will affect only the profitability of the fixed wireless local loop service; they will not affect whether it will be rolled out and offered to customers.

- c. Are you planning to use any Connect America funds for the 15 million home build out of your network that you are promising with this merger?**

No, our modeling has not taken in to account receiving any CAF funds.

- 5. We recently had a hearing on the IP transition in the Commerce Committee where we discussed the evolving IP-based communications systems and what that means for regulations, and particularly public safety. AT&T has been a significant player in the FCC’s decision to allow for IP trials to test the impacts of changes in communications technology on consumers and on the need for regulations to protect them. Is it correct that you will be testing the same wireless IP “cantennas” that you are highlighting in this merger as a new broadband option for rural consumers? How would you address the concerns that this wireless broadband connection is not adequate to provide quality, reliable connections for consumers?**

Yes, as part of our IP trials, we will be testing a fixed wireless local loop broadband offering in one of the trial wire centers. However, the trial will not be using “cantennas” but will be featuring a directional antenna.

AT&T’s fixed wireless local loop broadband offering will utilize wireless spectrum dedicated to that service and AT&T’s advanced LTE infrastructure (including professionally installed customer premises equipment) to provide a high quality, reliable broadband service at speeds and with usage allowances that are comparable to, and typically are better than, those of the best wireline broadband offerings available in those areas today.

- 6. Concerns have been raised over the years about AT&T’s implementation of its public, educational and government access (“PEG”) channel requirements. As I understand it there is one channel with a drop down menu that serves multiple**

jurisdictions. Is AT&T making any effort to improve this? As part of your upgrades and adding more value, will you work to improve your U-verse customers' access to PEG channels?

AT&T's PEG product is actually superior to that offered by cable operators from the perspective of subscribers, PEG producers, as well as municipalities, for several reasons. Among the most important are the following.

First, rather than providing subscribers access only to the community video programming of the municipality in which they live, AT&T's U-Verse PEG product offers subscribers access to the full range of PEG programming throughout a DMA. Consequently, AT&T's subscribers have access to far more PEG content than traditional cable system subscribers, and they can keep track of news, programming, and events in surrounding communities where they may work or family members may live. Second, and relatedly, AT&T's U-verse PEG programming is distributed to much larger audiences than cable operators' PEG programming, because distribution of PEG programming is limited only by relatively large DMA boundaries, not by relatively small municipal boundaries. This allows PEG programmers to spread their messages to audiences to which they would not otherwise have access.

AT&T's PEG programming can pass through Emergency Alert Service, closed captioning, and Secondary Audio Programming ("SAP") capabilities, and the picture quality is comparable to that of U-verse TV's standard definition commercial programs on linear channels. Of course, as with all of its video products, AT&T is committed to constantly reviewing its PEG service and implementing improvements, where appropriate.

RESPONSES OF RANDALL STEPHENSON TO QUESTIONS SUBMITTED
BY SENATOR FRANKEN

Senate Judiciary Committee, Antitrust Subcommittee Hearing
“The AT&T/DIRECTV Merger:
The Impact on Competition and Consumers in the Video Market and Beyond”
Questions for the Record Submitted by Senator Al Franken for Randall Stephenson

1. During the hearing, you said that you did not know whether AT&T has spent money lobbying for laws that restrict municipal broadband. Now that you have had an opportunity to consult appropriate documents and personnel, please answer the following questions: Has AT&T lobbied to restrict municipal broadband development? If so, please describe such efforts, including the amount of money spent on such efforts, the proposals for or against which AT&T has lobbied, and the states or locales in which such lobbying has taken place.

As discussed more fully in response to Question 4, building and operating broadband networks is best left to the private sector – as it requires expertise and an ongoing investment in network operations and upgrades. AT&T’s position, therefore, is that government owned networks (GONs) should only be funded and deployed where there is no private sector alternative (and other alternatives such as the Connect America Fund (CAF) implementation have been considered). Overbuilding does nothing to further the goal of extending broadband to those Americans who have no broadband access today. If governmental entities nonetheless pursue public ownership of broadband networks in a competitive market – which AT&T does not support – then in some instances we have advocated that appropriate safeguards be put in place to protect taxpayers and ensure a “level playing field” in a competitive market. Some of the safeguards AT&T has supported include:

- Commercial service providers should be given a right of first refusal in order to limit the need for government resources.
- To the extent the government regulates competing commercial providers, regulations must be applied to commercial and government-owned networks on a non-discriminatory basis.
- Government owned systems should be subject to the same laws and rules that govern commercial competitors.
- Government-owned systems should not receive preferential tax treatment. As an alternative, tax incentives/exemptions could be provided to service providers in order to increase the availability of the desired services.
- Government-owned systems should not be given preferential access to the right-of-way.
- Government-owned systems should not be allowed to make exclusive arrangements that prohibit commercial competitors from offering services.

We do not keep records on every bill or legislative measure that the company engages upon at the State level but we have advocated concerning GON-related legislation in at least the following States/regions: Arkansas, Connecticut, Florida, Indiana, Ohio, Puerto Rico, North Carolina, South Carolina, Tennessee, and Utah. In its advocacy related to GONs, AT&T did not hire lobbyists specifically for the purpose of working only on GONs-related legislation. Any AT&T lobbying efforts on GONs-related issues would have been/are handled consistent with our lobbying on other issues, that is, through AT&T’s employee lobbyists as well as external

lobbyists under general contract with the company. In addition, while not lobbying, AT&T has supported third-party coalitions/501c4 entities that raise awareness about the risks of GONs and the importance of placing appropriate conditions and safeguards on them.

2. **During the hearing, you stated: “I have personally advocated that where we are investing or others are investing private capital that we shouldn’t be required to compete against government taxpayer money.” According to the Institute for Local Self-Reliance, many municipal networks are financed by bonds to private investors that are repaid with revenues from the network. Do you believe municipal networks that are financed this way have a right to compete in an open marketplace?**

In the scenario you describe, whether the funding comes from a tax or from issuance of bonds, the network is still government owned, and thus AT&T’s position remains the same. As discussed in responses to Questions 3 and 4, AT&T’s position is that government owned networks (GONs) should only be considered where there is no private sector alternative (and other alternatives such as the Connect America Fund implementation have not addressed the issue). Moreover, GONs create a risk for taxpayers that should not be ignored in the current environment where many government entities are facing a challenging financial situation. That risk is not eliminated by use of government bonding authority versus taxpayer dollars.

The ability to repay the bond is based on revenue being generated by the network. If the GON does not generate sufficient revenue to repay the bond debt, taxpayers could be left with a significant burden. Local governments have a poor track record of projecting demand for their networks. As a result, GONs can and have failed to perform anywhere near the optimistic scenarios that are typically used when floating bonds to investors. The UTOPIA network in Utah offers an unfortunate example of this dynamic. Even after spending about \$500 million to deploy only a small part of this ambitious multi-city GON, the network has consistently failed to draw the number of subscribers needed to generate revenues sufficient to cover even their debt payments. A similar dynamic was evident in the downfall of GONs in Burlington, VT, Groton, CT, and Provo, UT. Municipalities that are unable to meet these obligations are oftentimes forced into uncomfortable situations. In the case of Burlington, it resulted in local officials making transfers from the city’s cash pool to cover these payments. In the case of the GON in Monticello, MN, officials have had to dip into other city funds to support this struggling network.

AT&T’s position remains that GONs should be considered only for unserved areas where a private sector business case does not exist. And even then, consideration must be given regarding the risk to taxpayers if the revenue from the GON falls short of expectations – that is the case whether funding with taxpayer dollars or using government bonding authority.

3. **How much federal taxpayer money has AT&T requested from the Connect America Fund to subsidize its broadband network?**

The Connect America Fund (“CAF”) is not funded with federal taxpayer money. Providers of interstate telecommunications and interconnected VoIP services are required to contribute to the federal universal service fund, of which the CAF is one component; these providers in turn generally recover their federal universal service contributions from end-user customers. AT&T

has received \$100 million in CAF Incremental Support, which its price cap carrier affiliates will use to deploy broadband to unserved areas. Additionally, AT&T received approximately \$176 million in CAF Frozen Support in 2013. Under the FCC's rules, price cap carriers were required to spend at least one-third of their CAF Frozen Support to build and operate broadband-capable networks in areas substantially unserved by an unsubsidized competitor. In 2014, that percentage increases from one-third to two-thirds. The FCC has not yet finalized its CAF Phase II rules.

- 4. During the hearing you stated: "[Unserved areas] seem like a logical place for government to step in and provide a solution." However, many restrictions on municipal broadband apply equally to all parts of a state, including unserved areas. Do you believe unserved areas should be exempt from such restrictive laws?**

Building and operating broadband networks is best left to the private sector – it requires expertise and an ongoing investment in network operations and upgrades. AT&T's position, therefore, is that government owned networks (GONs) should only be funded and deployed where there is no private sector alternative (and other alternatives such as the Connect America Fund (CAF) implementation have been considered).

As discussed in response to Question 1, if governmental entities nonetheless pursue public ownership of broadband networks in a competitive market – which AT&T does not support – then appropriate safeguards must be put in place (generally through state legislation) to protect taxpayers and ensure a "level playing field" in a competitive market. These safeguards include:

- Commercial service providers should be given a right of first refusal in order to limit the need for government resources.
 - To the extent the government regulates competing commercial providers, regulations must be applied to commercial and government-owned networks on a non-discriminatory basis.
 - Government owned systems should be subject to the same laws and rules that govern commercial competitors.
 - Government-owned systems should not receive preferential tax treatment. As an alternative, tax incentives/exemptions could be provided to service providers in order to increase the availability of the desired services.
 - Government-owned systems should not be given preferential access to the right-of-way.
 - Government-owned systems should not be allowed to make exclusive arrangements that prohibit commercial competitors from offering services.
- 5. AT&T has a history of blocking applications that compete with its own voice and messaging services, including Skype, Google Voice, and Apple's FaceTime. The FaceTime blocking ended once the FCC began investigating whether your company was violating the Open Internet Order. Do you believe these incidents contradict AT&T's stated commitment to net neutrality? Please explain why or why not.**

AT&T does not block applications that compete with its own voice and messaging services – or any other lawful applications for that matter – and it strongly disagrees with your statement that AT&T has a history of blocking such applications.

With respect to your assertions regarding Skype, Google Voice and Facetime, AT&T respectfully disagrees with your characterization. AT&T permits, and has always permitted, users of its fixed and mobile broadband Internet access services to access any lawful website of their choosing. AT&T does not block or otherwise restrict such access and has never done so, and AT&T's customers have always been able to launch VoIP and other applications through such access. Prior to October 2009, however, AT&T and Apple agreed that Apple would not take affirmative steps to enable an iPhone to use AT&T's wireless service to make VoIP calls. This restriction was limited to the iPhone and stemmed from the substantial and unprecedented subsidies AT&T was providing for iPhone purchases. These restrictions were lifted, first for iPhone VoIP applications using Wi-Fi connectivity, and then in October 2009, for VoIP applications that used AT&T's wireless network. That was more than a year before the FCC adopted its Net Neutrality rules.

AT&T's temporary limits on the use of FaceTime were fully consistent with the letter and spirit of Commission's Net Neutrality rules, which expressly recognize the imperative of reasonable network management. FaceTime is a highly bandwidth intensive application. When Apple made available iOS6, which for the first time permitted use of FaceTime on cellular networks, FaceTime had already been preloaded on tens of millions of AT&T customer iPhones. Particularly, given Apple's reputation for high quality design, AT&T was concerned that the launch of iOS6 could result in a flood of FaceTime usage that would adversely impact service quality for all customers. AT&T was particularly sensitive to this concern as it was widely known at the time that AT&T had experienced congestion on its network as a result of the extraordinary popularity of the iPhone and the way in which that device revolutionized mobile data usage. It is for this reason, and no other, that AT&T decided to take the prudent course of action with respect to FaceTime by phasing it in, first with our Mobile Share customers, then with our tired plan customers, and, finally, with our unlimited plan customers. This process enabled us to monitor usage of FaceTime and its impact on our network and ensure that our mobile experience was the best it can be for all of our customers. We made FaceTime available to all customers, not because of any FCC investigation (there was no formal investigation), but because we were committed to doing so as soon as we could conclude that it would not result in an adverse impact on service quality.

6. Do you believe the Open Internet Order allows for paid prioritization?

The Open Internet Order by its terms did not prohibit all prioritization but it created a strong presumption against the form of paid prioritization that is of most concern to Open Internet interest groups – sometimes referred to as “pay for priority.” The Commission described this as “a commercial arrangement between a broadband provider and a third party to directly or indirectly favor some traffic over other traffic in the broadband Internet access service connection to a subscriber of the broadband provider (*i.e.*, “pay for priority”).”¹ The

¹ *Open Internet Order*, para. 76.

Commission concluded that such arrangements “would raise significant cause for concern” and therefore “it is unlikely that pay for priority would satisfy the ‘no unreasonable discrimination’ standard.”²

Net Neutrality advocates have not called for a prohibition on all types of paid prioritization – and for good reason. Instead, Net Neutrality advocates have conceded that paid prioritization is a concern only when it is *not* directed by end users. These advocates have acknowledged that “user-driven prioritization is *unobjectionable* and should be a capability that is preserved in the course of enacting any new Internet openness rules.”³ As the Center for Democracy & Technology explained in 2010, “CDT and others have repeatedly made a clear distinction between paid prioritization and user-driven prioritization”; prioritization that “would occur on the user’s last-mile facilities at *the user’s request*” should be permissible.⁴ That is because user-driven prioritization, CDT emphasized, poses no threat to “Internet openness.”⁵ Similarly, Free Press has explained that its “long-held position” is that “prioritization over open Internet services” that is “purely edge-driven prioritization, such as the prioritization used in many business services and protected through service level agreements,” is permissible.⁶ In other words, Free Press has acknowledged that “user-driven method[s]” of prioritization are not objectionable.⁷

The FCC agreed. As the Open Internet Order concluded, “[a] strict nondiscrimination rule would be in tension with [the FCC’s] recognition that some forms of discrimination, including end-user controlled discrimination, can be beneficial.”⁸ At the same time that it created a presumption against paid prioritization (*i.e.*, pay for priority), the Open Internet Order concluded that “[m]aximizing end-user control is a policy goal Congress recognized in Section 230(b) of the Communications Act, and end-user choice and control are touchstones in evaluating the reasonableness of discrimination.”⁹ Moreover, fully consistent with the views of Net Neutrality advocates, the Open Internet Order appropriately excluded enterprise service offerings, which typically allow customers to designate certain traffic for prioritization.¹⁰ These user-driven services have been used for years without any threat or harm to the open Internet.

7. Sprint is reportedly nearing an agreement to acquire T-Mobile. Sprint and its parent company, Softbank, say they need a merger to compete with AT&T and Verizon in the wireless market. What do you make of this argument?

² *Id.*

³ CDT *ex parte*, GN Docket No. 09-191, at 2 (Sept. 8, 2010) (emphasis added); *see id.* (explaining that Differentiated Services architecture is different from paid prioritization that concerns Net Neutrality advocates because the former “would be a capability offered to users and would occur on the user’s last-mile facilities at the user’s request”).

⁴ *Id.* (emphasis added).

⁵ *Id.*

⁶ Free Press *ex parte*, GN Docket Nos. 07-52, 09-191, at 1 (Oct. 6, 2010).

⁷ Free Press *ex parte*, GN Docket No. 09-191, at 3 (Aug. 3, 2010).

⁸ *Id.*, para. 77.

⁹ *Open Internet Order*, para. 71.

¹⁰ *Id.*, para. 45.

Sprint is owned by one of the largest telecom/Internet companies in the world with other telecommunications holdings and considerable resources at its disposal. If and when a Softbank/T-Mobile deal is announced, we will review the application and decide what, if any, position to take with respect to it.

RESPONSES OF MICHAEL WHITE TO QUESTIONS SUBMITTED
BY SENATOR KLOBUCHAR

Senator Klobuchar
Questions following the AT&T/DIRECTV Hearing

For Mr. White

1. Your testimony implied that the only way to offer customers a single bill is by merging with AT&T. However, AT&T's website indicates that it is possible for customers to receive a single bill with an AT&T/DIRECTV synthetic bundle if they the bundle from AT&T.¹ In fact, Michael Katz, an economist who contributed to AT&T's public interest filing with the FCC, specifically notes that a \$5 discount is given to customers who sign up through AT&T to receive only one bill. Why is this merger required to give this particular convenience to customers? Why is DIRECTV not offering a single-bill option today? Given that AT&T is already able to offer one bill to customers, should this be considered by the subcommittee and the antitrust agencies as a merger specific efficiency?

Providing a single bill is absolutely a merger-specific efficiency for DIRECTV. Although we have worked to provide a single bill for more than a decade, the cost of doing so simply isn't justified in the absence of a merger.

To your specific question—why AT&T can offer a single bill when DIRECTV cannot—one answer is that AT&T already has the technology in place and we do not. In the wake of industry consolidation in the late 1990s and early 2000s, telephone companies (including AT&T) developed and deployed a technology called EMI that, essentially, allows one company's billing systems to "understand" the billing system of another company. (This could be thought of as akin to the technology that allows Microsoft Word to convert WordPerfect files.) Because AT&T has already deployed this technology, its billing system can import and use data from DIRECTV's billing system.

This technology, however, works in only one direction. Unless DIRECTV adopts the EMI or similar technology itself, it cannot import and use data from AT&T's billing system. Moreover, it would have to add technology that could read broadband billing data and voice billing data separately. And, since DIRECTV has eight separate bundle partners, we would have to implement this technology repeatedly. We estimate that the total cost could approach \$80 million overall. We have examined this issue repeatedly, but could never justify such expenditures in light of the expected incremental return they would generate (reflected either in increased revenue or decreased customer churn). This is especially true given that an independent broadband provider is under no obligation to renew our relationship in the future, and thus our investment could be stranded after only a few years.

This transaction changes these unfavorable conditions in two ways. Generally, it will give the parties strong incentives to seek common technology platforms in

¹ <http://www.att.com/shop/bundles/directv-internet-phone.html> "Why Bundle? . . . Make payments on one bill."

order to capture efficiencies of scope and scale, which themselves might be sufficient to offset some or all of the cost of integration. Specifically, it will allow a single entity to serve all bundle customers for the combined company, allowing AT&T to use its existing technology to offer single bills, even for independent broadband providers with which DIRECTV will continue to have “synthetic” bundle arrangements.

2. How does this merger fix the problem of “double marginalization?” According to you and Mr. Stephenson, if the merger is permitted, only one company needs to make a profit on an integrated bundle, rather than two with a synthetic bundle. However, the combined AT&T/DIRECTV would only have one other bundle to compete with in most markets. Will such a duopoly result in the cost savings from converting a synthetic bundle into a regular bundle being passed onto consumers?

As Dr. Michael Katz explained to the FCC, a merger of companies that sell complementary products (like broadband and video) eliminated “double marginalization,” which in turn creates downward pressure on prices. As he puts it:

When two products are sold by independent firms, neither seller takes into account the effects of its price on the sales and profits of the other seller. A combined firm, however, considers the effects of each of its prices on the sales and profits derived from both products. . . . Absent a merger, two firms selling complementary products set their prices or margins higher than is jointly optimal, leading to what is known as a “double marginalization” problem.

He further explains that, because it solves the double-marginalization problem, a merger between providers of complementary products creates downward pricing pressure even in the absence of any efficiencies in the form of cost savings or quality improvements. In other words, even if this transaction would generate no other cost savings at all, it would create downward pricing pressure on the rates charged consumers.

In order to test economic theory, Dr. Katz conducted an extensive simulation analysis. The simulation demonstrates that the proposed merger will place downward pressure on (1) the price of bundles combining AT&T’s Internet access services and DIRECTV’s video services; and (2) the prices charged by cable companies within AT&T’s footprint for their Internet access and video services, both when sold in bundles and on a standalone basis.

RESPONSES OF MATTHEW F. WOOD TO QUESTIONS SUBMITTED
BY SENATOR KLOBUCHAR

Senator Klobuchar
Questions following the AT&T/DIRECTV Hearing

For Mr. Wood

1. Should consumers be wary of the fixed wireless local loop offering that AT&T is proposing to offer to 13 million rural customers? Are these fixed wireless IP offerings more expensive? Will this be a competitive option for rural consumers?

Answer:

Yes, consumers should be wary of the suggestion that fixed wireless local loop offerings are a perfect or even close substitute for wired home phone and broadband connections. For one thing, they should be wary of accepting this as a merger-specific benefit. As I noted in my written testimony, AT&T announced in May 2014 that its Wireless Home Phone & Internet service is already available nationwide – with AT&T defining “nationwide” as the territory served by its existing wireless network “which covers more than 99% of all Americans.”¹ In light of that announcement, it is hard to understand who these additional 13 million rural customers are, where they live, or what additional benefits the merger supposedly brings them.

More troubling than questions about *who* will receive this allegedly new service are questions about *what* they will receive. Fixed wireless offerings can indeed be far more expensive than wired services, even when the wired options provide far greater capacity. That makes fixed wireless plans a very uncompetitive option for rural consumers, at least on price.

For example, “AT&T’s fixed LTE service runs \$60 a month with a 10 Gigabyte cap, \$90 per month for 20 GB, or \$120 for 30 GB. Once that cap is exceeded, AT&T charges \$15 per 1 GB of data.”² That pricing structure compares very unfavorably to AT&T’s wired “residential” and “U-verse High Speed Internet service” plans. The residential plan customers are allotted 150 GB per month by AT&T – or five times more than the apparent top tier for the current fixed wireless offering – while U-verse users receive 250 GB per month.³

While prices may vary from geographic market to geographic market, the base or introductory rate for these wired broadband services maybe as low as \$14.95 to \$29.95 per month, for the aforementioned 150 to 250 gigabytes.⁴ The fixed wireless plans apparently start at \$60 per month (twice as much money) for 10 gigabytes (one-fifteenth of the data). The overage fees are dramatically lower for the wired services too, with a \$10 charge for every 50 GB increment over the cap. The same “extra” 50 GB on a fixed wireless plan, at the rates announced by AT&T in May, would cost the customer an incredible \$750 – or seventy-five times more.

¹ See AT&T Consumer Blog, “AT&T Wireless Home Phone & Internet Goes Nationwide, and So Can You,” May 22, 2014 (available at <http://blogs.att.net/consumerblog/story/a7795364>).

² See Jeff Baumgartner, “AT&T’s Fixed Wireless Service Goes Nationwide,” *Multichannel News*, May 23, 2014. (available at <http://www.multichannel.com/news/technology/att-fixed-wireless-service-goes-nationwide/374744>).

³ See AT&T Broadband Usage FAQs, “High Speed Internet Support” (last visited July 28, 2014) <http://www.att.com/esupport/article.jsp?sid=KB409045&cv=801#fbid=1wctqva16Dz>.

⁴ See AT&T U-verse High Speed Internet “Shop” page (last visited July 28, 2014) <http://www.att.com/shop/internet/u-verse-internet.html>.

2. This merger is primarily about video service, but mobile phone service is relevant as well because this merger involves one of the top two wireless carriers and we are beginning to see wireless, broadband and video markets converge. AT&T will gain significant relationships by acquiring its DIRECTV's 20 million subscribers. What's the significance of this deal to the wireless industry and how could it impact wireless competition?

Answer:

This merger is indeed relevant to – and problematic for – the pay-TV, fixed broadband, and mobile wireless markets, whether consumers purchase those products separately or as a bundle.

As I noted in my written testimony, there is some question from analysts about the cost synergies and savings that AT&T truly would experience from this merger. But whatever savings the company experiences, even more doubtful than the size of these benefits for the merging parties is whether or not they would pass these savings along to consumers.

There is no real indication from AT&T that any synergies would translate to price reductions, and Mr. Stephenson was hesitant to offer a clear answer to direct questions on this topic at the hearing. Nor is there any likelihood that customers would see price reductions in an uncompetitive market. AT&T's only motivation and likely course of action will be to pocket any savings and send them to shareholders, rather than offering them to customers or investing them in networks. The deal may be significant for AT&T's bottom line, yet could lead to increased revenues and profits for the company with no increased benefits for customers.

AT&T may intend to provide more video content to its mobile wireless customers as a result of acquiring programming rights as it acquires DIRECTV, and it may attempt to pitch this increase in video content as both a spur to competition and a benefit to mobile wireless subscribers. But as in all cases, the value and net benefit of such offerings for consumers must be measured by examining the actual options presented to them – not by reference to any new content or packages that wireless customers are *forced* to purchase automatically in a bundle.

SUBMISSION FOR THE RECORD

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS



815 Sixteenth Street, N.W. • Washington, D.C. 20006 • (202) 637-5000 • www.aflcio.org

LEGISLATIVE ALERT

EXECUTIVE COUNCIL

RICHARD L. TRUMKA
PRESIDENTELIZABETH H. SHULER
SECRETARY-TREASURERTEFERE GEBRE
EXECUTIVE VICE PRESIDENT

June 25, 2014

Dear Senator:

On behalf of the 12 million members of the AFL-CIO, I am writing in support of the proposed merger of AT&T and DIRECTV.

The AFL-CIO evaluates any proposed merger against two criteria. First, does the proposed merger serve the public interest? Second, does the proposed transaction serve the interests of the workers who will be affected by the merger? The proposed AT&T/DIRECTV merger is favorable on both counts.

For consumers, the AT&T/DIRECTV merger presents few anti-trust concerns since AT&T and DIRECTV primarily serve different markets. The combination of AT&T and DIRECTV will result in a stronger competitor to the dominant cable industry, providing consumers with more options, putting pressure on prices and improving service in the video market. Moreover, a merged AT&T/DIRECTV will provide consumers across the nation a one-stop shop for a bundled broadband/video service.

The AT&T/DIRECTV merger will also bring benefits to employees. AT&T respects the rights of its employees to make their own choice about union representation, and is now the largest full-time unionized employer in the US.

Given AT&T's commitment to respecting the rights of its employees and the fact that a combined AT&T/DIRECTV will result in increased competition, we believe the AT&T/ DIRECTV merger will be in the best interest of both workers and consumers.

Sincerely,

William Samuel, Director
Government Affairs Department

SUBMISSION FOR THE RECORD

**Communications
Workers of America**
AFL-CIO, CLC

501 Third Street, N.W.
Washington, D.C. 20001-2797
202/434-1110 Fax: 202/434-1139

Larry Cohen
President

June 20, 2014

The Honorable Amy Klobuchar
United States Senate
Washington, D.C. 20515

Dear Madam Chairwoman,

The Communications Workers of America supports the proposed merger of AT&T and DIRECTV. We believe that it will expand high road labor standards and create substantive video competition.

The transaction presents little anti-trust concerns. AT&T and DIRECTV primarily serve different markets. AT&T is primarily a broadband and wireless carrier, whereas DIRECTV is a satellite video provider. AT&T is a new entrant in the video market, serving 5.7 million customers.

Programming represents about 60 percent of the cost of the pay TV business. AT&T anticipates that it will be able to save 20 percent on video programming after the merger. This will make a combined AT&T/DIRECTV a more formidable competitor to the dominant, incumbent cable company, driving price pressure and quality improvements for consumers.

Moreover, video is the major driver of the economics of broadband expansion. Thus, a merged AT&T/DIRECTV will be more likely to expand its high-speed broadband network to more places.

AT&T has already filed its public interest statement for this transaction at the Federal Communications Commission. In it, AT&T makes clear commitments which reinforce the value of the transaction for the public. For eight years, CWA's "Speed Matters" campaign has sought investment in high speed networks for underserved rural and urban communities. We are confident that industry regulators will secure those public interest benefits as part of their regulatory review.

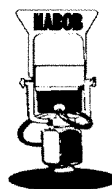
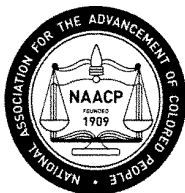
AT&T has the largest full-time union workforce of any company in America. From experience, we know that AT&T respects the rights of employees to make their own choice about union representation and engage in collective bargaining to establish their wages and benefits.

We look forward to working with members of your committees to make sure that the worker, consumer, and public interest potential of this merger is fully realized.

Sincerely,


Larry Cohen
President

SUBMISSION FOR THE RECORD



June 23, 2014

The Honorable Spencer Bachus
Committee on the Judiciary
Subcommittee on Regulatory Reform, Commercial and Antitrust Law
U.S. House of Representatives
Washington, DC 20515

The Honorable Hank Johnson
Ranking Member
Committee on the Judiciary
Subcommittee on Regulatory Reform, Commercial and Antitrust Law
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Bachus and Ranking Member Johnson:

We write to you today in anticipation of your upcoming subcommittee hearing on the proposed AT&T-DirecTV merger to highlight a few important points related to this potential merger and its effect on programming choices and media access for the African-American community, as well as other racial and ethnic minority communities and viewers in America.

As we noted in a similar letter we sent to you last month concerning the proposed Comcast-Time Warner Cable merger, an active, robust and diverse media sector, both in terms of ownership and content, is essential for the success of a modern democratic society. Our nation's media systems, from broadcast television and radio, to cable television, should be fully representative of the communities that they serve. Less than ten years ago, there were 21 full-power commercial television stations licensed to African-American controlled companies in the United States, and even though 21 stations is woefully short of parity, today it's gotten worse, there are only four. Unfortunately, to make matters even more deeply concerning, there are no present indicators that this dismal decline in diverse media ownership is likely to be reversed in the foreseeable future.

One of the glimmers of hope can be found in minority-owned cable networks, like TV One, which provides daily news and quality original programming, from the African-American perspective, as well as shows like the prestigious NAACP Image Awards.

Authentic and positive representation of African-American culture, history and diversity are welcomed and sorely needed.

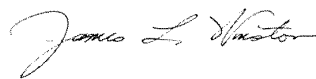
The way the public views certain issues about our communities, our Nation, and our world is directly related to the manner in which these subjects are covered by available media. We must have the voices of and platforms for racial and ethnic minorities, including African-Americans, who have scale to achieve the goal of diverse, fair, balanced and comprehensive coverage. This means that the interest of a racially and ethnically diverse public is best addressed when our Nation's media systems are representative of, accessible to, and affordable by the communities that they serve. We hope that you and the committee members will explore these important issues at the upcoming hearing. We also think it's important to note AT&T's strong working relationship with their union employees and for their commitment to have the same opportunities made available to the DirectTV employees they will retain in the acquisition. We believe this is good for both the new company and for the consumers we serve.

Thank you for the opportunity to share our views with you during this crucial hearing process. If you have any questions on this matter, you can reach Hilary O. Shelton, Director of the NAACP Washington Bureau and Senior Vice President for Policy and Advocacy at (202) 463-2940 or Jim Winston, NABOB Executive Director and General Counsel.

Sincerely,



Hilary O. Shelton
Director
NAACP Washington Bureau and
Senior Vice President for Policy and Advocacy



James L. Winston
NABOB Executive Director and
General Counsel

cc: Members
Committee on the Judiciary
Subcommittee on Regulatory Reform, Commercial and Antitrust Law
U.S. House of Representatives